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IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

AMOCO PRODUCTION COMPANY, *et al.*,
Petitioners,

v.

PUBLIC SERVICE COMPANY OF COLORADO, *et al.*,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a court of appeals may review *de novo*—rather than for abuse of discretion—an administrative agency's exercise of the remedial authority delegated to it by Congress.

PARTIES TO THE PROCEEDING BELOW

The following entities were parties to the proceeding in the court of appeals:

Amoco Production Company
Anadarko Petroleum Corporation
Cheyenne Light, Fuel and Power Company
Colorado Interstate Gas Co.
Federal Energy Regulatory Commission
K N Energy Inc.
K N Interstate Gas Transmission Co.
Missouri Public Service Commission
Mobil Oil Corporation
OXY USA Inc.
Public Service Company of Colorado
Union Pacific Resources Company

PARENT COMPANIES AND NONWHOLLY OWNED SUBSIDIARIES

The parent companies of Amoco Production Company are Amoco Company and Amoco Corporation. Amoco Production Company has the following nonwholly owned subsidiaries:

Azerbaijan International Operating Company
Beacon Gas Limited
East Tanka Petroleum Company
East Texas Salt Water Disposal Co.
Egypt Trans Gas Company
Ekma Oil Company
Energia Del Sur S.A.
Gulf of Suez Petroleum Company
K 10A Production B.V.
K/S Statfjord Transport A.S. & Company
Natural Gas Vehicles Company
Nile Delta Oil Company
North October Petroleum Company
Rudeis Oil Company
Sharjah LPG Company, Limited
Statfjord Transport A.S. & Company
Termap, S.A.
Torsina Oil Company

Anadarko Petroleum Corporation has no parent companies or nowholly owned subsidiaries.

The parent company of Mobil Oil Corporation is Mobil Corporation. Mobil Oil Corporation has no nonwholly owned subsidiaries.

The parent company of OXY USA Inc. is Occidental Petroleum Corporation. Canadian Occidental of California, Inc. is a nonwholly owned subsidiary of Occidental Petroleum Corporation.

The parent companies of Union Pacific Resources Company are Union Pacific Resources Group Inc. and Resources Holding, Inc. The following entities are non-

wholly owned subsidiaries of Union Pacific Resources Company:

Austin Chalk Natural Gas Marketing Services (Partnership)
Austin Chalk Pipeline, L.P.
CC Global Chemicals Company
EasTrans Limited Partnership
East Texas Gas Systems
Enterprise Products Co./Texaco Producing J.V.
Ferguson Burleson County Gas Gathering System
Frontier Pipeline Capital Corp.
Frontier Pipeline Company
LaGrange Oil Terminal Partnership
Mont Belvieu I Fractionation Facility (Partnership)
Mon Belvieu Fractionation J.V.
Overland Trail Transmission Company, L.P.
Ozona Dev. Drilling Partners I
Ozona Dev. Drilling Partners II
Ozona Dev. Drilling Partners III
Ozona Gas Processing Plant
Panola Products Pipeline Company
South Jersey Resources Group LLC
The Western Market Center J.V.
Union Pacific Caroline Gas Facilities Limited Partnership
Union Pacific Gas Marketing 1991-A (Ltd. Partnership)
Union Pacific Gas Producing 1991-A (Ltd. Partnership)
UP Bryan Plant (Partnership)

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PETITION FOR WRIT OF CERTIORARI

Amoco Production Company, Anadarko Petroleum Corporation, Mobil Oil Corporation, OXY USA Inc., and Union Pacific Resources Company (collectively, the "producers") petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-30a) is reported at 91 F.3d 1478. The Federal Energy Regulatory Commission's decision (Pet. App. 35a-59a) is

reported at 65 FERC ¶ 61,292; the Commission's order denying rehearing (Pet. App. 60a-83a) is reported at 67 FERC ¶ 61,209.

JURISDICTION

The judgment of the court of appeals was entered on August 2, 1996. Timely petitions for rehearing and rehearing *en banc* were denied on November 6, 1996. Pet. App. 31a-34a. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The relevant provisions of the Natural Gas Policy Act of 1978 ("NGPA") are reproduced at Pet. App. 103a-108a.

STATEMENT OF THE CASE

This case presents an important, recurring issue of administrative law. Instead of prescribing specific remedies for violations of a federal regulatory statute, Congress often entrusts to the agency charged with administering the statute the discretion to shape a remedy appropriate to the facts and equities of a particular case. This case arises under the NGPA, one of the numerous laws that fit this pattern.[1] No provision of that statute requires FERC to award refunds in the case of a pricing violation. Rather, Congress left that question to the sound judgment of the Commission.

At issue in this case is the standard to be applied when a court reviews an exercise of such remedial authority. In 1993, overturning a series of prior administrative decisions, FERC ruled for the first time that natural gas producers should not be allowed to recover, as part of the price charged to their customers, certain tax costs

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[1] Among the other statutes that give agencies broad remedial discretion are the Communications Act of 1934, 47 U.S.C. §§ 151 *et seq.*, the Federal Power Act, 16 U.S.C. §§ 791 *et seq.*, and the Natural Gas Act, 15 U.S.C. §§ 717 *et seq.*

incurred in connection with the production of natural gas. In light of its own earlier orders expressly authorizing recovery of such costs, the Commission decided to order refunds only for the period during which producers were reasonably on notice that the vitality of the prior rulings was in doubt.

The D.C. Circuit reversed FERC's carefully tailored remedial determination and ordered massive retroactive refunds far greater than those deemed reasonable by FERC. The decision undermines FERC's policy objectives by exposing natural gas producers and royalty owners to as much as $499 million in potential liability for conduct that was fully in accord with the Commission's authoritative view of the law at the time. In reaching its decision, the court gave no deference at all to the agency's judgment. Instead, it reviewed the agency's ruling *de novo,* relying exclusively on its own independent remedial judgment. In this respect, the D.C. Circuit's decision conflicts sharply with the decisions of other circuits, which hold that agency remedial determinations are to be reviewed deferentially only for abuse of discretion.

A. Regulatory Background

In 1974, when FERC's predecessor, the Federal Power Commission ("FPC"), first prescribed nationwide maximum rates for producer sales under the Natural Gas Act, it provided that "[t]he applicable [maximum] rate shall be adjusted upward for all State or Federal production, severance, or similar taxes." Opinion No. 699, 51 F.P.C. 2212, 2301 (1974). Later that year, the FPC held that the Kansas *ad valorem* tax qualified for recovery under this provision because, though nominally imposed on the value of mineral property, that tax was actually "based on production factors" and therefore operated as "a severance or production tax merely bearing the title 'ad valorem tax.' " Opinion No. 699-D, 52 F.P.C. 915, 915

(1974). The FPC's ruling thus expressly authorized natural gas producers to increase their otherwise applicable maximum rates to include the costs of this Kansas tax.

In enacting the NGPA in 1978, Congress codified the FPC's prior regulatory treatment of state tax costs. In particular, section 110 of the NGPA provided that the price charged for the first sale of natural gas could exceed the otherwise applicable maximum lawful price to the extent necessary to recover "State severance taxes attributable to the production of . . . natural gas and borne by the seller." 15 U.S.C. § 3320(a)(1) (1988).[2] And, using language nearly identical to that employed in Opinion No. 699, the statute defined a "State severance tax" to include "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." 15 U.S.C. § 3320(c) (1988).

The NGPA's legislative history also demonstrated Congress's intent to endorse the FPC's flexible *application* of Opinion No. 699. Of particular relevance here, the Conference Report, in an obvious reference to the FPC's treatment of the Kansas *ad valorem* tax, specified that the term "State severance tax" included "any tax imposed upon mineral or natural [gas] production, *including an ad valorem tax*." H.R. Conf. Rep. No. 1752, 95th Cong., 2d Sess. 91 (1978), *reprinted in* 1978 U.S.C.C.A.N. 8983, 9007 (emphasis added).

In accord with the language and obvious purpose of section 110, FERC thereafter incorporated the FPC's pre-NGPA regulatory principles—and, in particular, the pre-NGPA ruling on the Kansas *ad valorem* tax—into its post-NGPA analysis. In the years immediately following the NGPA's enactment, FERC twice relied on the pre-NGPA Kansas tax decision in authorizing producers to recover the costs of other state taxes under section 110 of the NGPA. *See Independent Oil & Gas Ass'n*, 7 FERC

[2] Section 110 was repealed effective January 1, 1993, as part of Congress's decision to deregulate wellhead prices of natural gas. Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, § 2(b), 103 Stat. 157 (1989).

¶ 61,094, at 61,143 (1979); *Trio Petroleum Corp.*, 18 FERC ¶ 61,203, at 61,412 (1982).

B. Earlier Proceedings in This Litigation

In 1983, Northern Natural Gas Company asked FERC to "reopen, reconsider and rescind" the FPC's 1974 Kansas tax ruling and to rule instead that natural gas producers could *not* recover the cost of the Kansas *ad valorem* tax. C.A. App. 77. FERC denied Northern Natural's request and reaffirmed its earlier decision in the Kansas tax. *See Sun Exploration & Prod. Co.*, 36 FERC ¶ 61,093 (1986), *reh'g denied sub nom. Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987). (These decisions are reproduced at Pet. App. 84a-97a, 98a-101a.) The Commission explained that the NGPA had "codified the [pre-existing] approach" to recovery of state tax costs (Pet. App. 87a) and that the Commission had continued to rely on that approach in its post-NGPA rulings. *Id.* (citing *Independent Oil & Gas Ass'n, supra*). The Commission further noted that the Kansas tax itself had not been altered in any way that strengthened Northern Natural's case. Pet. App. 90a-91a. FERC thus saw "no reason to change the FPC's conclusion" on this issue. Pet. App. 91a.

On review of that decision, the D.C. Circuit held that the Commission's opinion did not sufficiently articulate why the Kansas tax qualified as a "severance, production, or similar tax" under NGPA section 110. The court accordingly remanded the matter to the Commission for further explanation. *See Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769, 771 (D.C. Cir. 1988).

On remand, FERC changed course. It overruled its prior, directly contrary decisions and held for the first time that natural gas producers should not be allowed to recover the cost of the Kansas tax. *See* Pet. App. 43a-49a, 65a-72a.[3]

The Commission then turned to the critical question of remedy—a question that, the Commission emphasized,

[3] Although the producers challenged this ruling below, they do not pursue the issue in this Court.

required a "discretionary" judgment involving the agency's "consider[ation] [of] the equities of the case." Pet. App. 75a (internal quotation omitted). FERC explained that a key equitable factor here was that natural gas producers have long had "settled expectations"—anchored both in the agency's explicit prior rulings and in the language and legislative history of the NGPA—that they could recover the cost of the Kansas tax. Pet. App. 51a-53a, 78a-79a. In support of that conclusion, the Commission gave a detailed account of the history outlined above. It noted that "starting in 1974, the Commission and its predecessor had found that Kansas' *ad valorem* tax was similar to a production or severance tax"; that the language and history of the NGPA "support[ed] the view that the prior characterization of the Kansas tax would carry over under the NGPA"; and that the Commission had subsequently "found certain state taxes qualified under section 110 as a similar tax relying on the FPC's prior characterization of the Kansas tax." Pet. App. 78a.

The Commission reasoned that it was not until the *Colorado Interstate Gas* decision in 1988, when the D.C. Circuit became the first official body to question the prior treatment of the Kansas tax, that producers had any reason to doubt that they could pass through this cost. *Id.* FERC accordingly decided that the appropriate equitable balance—the proper use of its "wide latitude of discretion" in framing a remedy (Pet. App. 75a)—was to award partially retroactive refunds, *i.e.*, refunds limited to the period after that 1988 ruling. Pet. App. 52a-53a, 78a-79a.[4]

C. The Decision Below

The matter then returned to the D.C. Circuit. That court affirmed FERC's new position on the Kansas tax but reversed the Commission's refund decision.

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[4] In accordance with the Commission's order, natural gas producers have already refunded millions of dollars of tax costs that they passed through after 1988.

On the latter issue, the court accorded no deference to the Commission's remedial judgment but, instead, relied solely on its own assessment of the appropriate remedy. The focus of the court's independent analysis—the lone "crucial point," as the court "s[aw] the issue"—was the alleged "lack of detrimental reliance on the part of the producers" (Pet. App. 23a), a factor that operated as a kind of threshold disqualification stripping the agency of any discretion to deny or limit refunds. Under the court's notion of "detrimental reliance," moreover, it was not enough for the Commission to show that producers had actually passed through the Kansas tax costs in reliance on the agency's rulings expressly authorizing them to do so. The Commission was required to point to some *other* decision that producers would have made differently if they had known at the time that they could not recover the cost of the Kansas tax. Since producers could not have raised their rates further to make up the difference, and since the record was silent on whether the producers would have reduced production, shut in wells, or refrained from exploring for new wells, the court inferred that FERC had failed to establish the necessary "detrimental reliance." *Id.*

The court of appeals further stated that after 1978, when Congress enacted the NGPA, any reliance on the part of the producers would not have been "reasonable" —indeed, would have been "foolhardy"—because "enactment of a substantially new regulatory regime in 1978 undermined any assurance that the FPC's treatment of the Kansas tax . . . would withstand scrutiny under the NGPA." *Id.* at 24a. In reaching that conclusion, the court did not address—much less exhibit deference to—FERC's contrary reasoning that the language and legislative history of the NGPA, together with the Commission's own later decisions incorporating the pre-NGPA analysis of the Kansas tax, would have led gas producers reasonably to conlude that the earlier ruling on that tax remained the law.

On the strength of its independent analysis, the D.C. Circuit believed that it would have been appropriate—despite the agency's consistent rulings expressly authorizing recovery of the Kansas tax—to order refunds of all Kansas tax costs that producers had recovered since the NGPA's enactment in 1978. *Id.* But because not even the parties seeking refunds had thought to preserve an argument seeking such draconian relief, the court was constrained to hold that "the producers' liability for refunds extends back to October 1983"—"the earliest date for which any argument has been preserved in this proceeding for review." *Id.* at 24a, 29a.

The court of appeals denied timely petitions for rehearing and suggestions for rehearing *en banc* filed both by FERC and by the producers. Pet. App. 31a-33a.[5] The court subsequently stayed its mandate, pursuant to Fed. R. App. P. 41(b), pending the filing and final disposition of this petition for certiorari. Pet. App. 102a.

REASONS FOR GRANTING THE PETITION

The decision below conflicts with the rulings of other courts of appeals on a recurring issue of administrative law that goes to the heart of the relationship between expert agencies and the federal judiciary.

Other courts of appeals, drawing on principles enunciated by this Court, have emphasized that Congress has charged administrative agencies, not the courts, with the responsibility of crafting remedies that balance equitable concerns in a manner that best serves often competing statutory objectives. Those courts have accordingly held that judicial review of such remedial judgments is extremely deferential: a court may set aside an agency's

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[5] The court also denied a petition for rehearing filed by Public Service Company of Colorado and Cheyenne Light, Fuel and Power Company, who asked the court to reconsider its holding insofar as it denied refunds back to 1978. Pet. App. 34a.

exercise of remedial discretion only if it lacks a rational basis or constitutes an abuse of discretion.

Had such a standard been applied in this case, the Commission's decision to limit retroactive refunds to periods after 1988 surely have been upheld. FERC's determination was a plainly reasonable exercise of equitable discretion—it took proper account of producers' settled expectations based on prior Commission rulings expressly authorizing recovery of the Kansas tax costs. This is precisely the kind of Commission analysis, moreover, to which other circuits have previously deferred in similar circumstances.

The D.C. Circuit, however, applied a very different standard of review and reached a contrary result. Without ever grappling with the agency's reasoning, the court undertook an entirely independent analysis of the remedial question. The court of appeals decided what factor *it* believed was most relevant to the refund inquiry, determined what *it* believed the record demonstrated as to that factor, and mandated the specific remedial result *it* believed best. It thus reversed the Commission's decision simply because it differed from the court's own independent conclusion, not because it fell outside the zone of reasonable decisions. That application of *de novo* review cannot be squared with the decisions of other circuits and threatens to undermine key aspects of agency authority.

1. In a wide variety of contexts, other courts of appeals have concluded that, out of respect for the authority that Congress has vested in expert administrative agencies, their review of agency remedial judgments must be deferential. The Seventh Circuit, for example, drawing on this Court's precedents, recently explained that "[w]here . . . Congress has entrusted an administrative agency with the responsibility of selecting the means of achieving the statutory policy, 'the relation of remedy to policy is peculiarly a matter for administrative competence.' "

Lesser v. Espy, 34 F.3d 1301, 1309 (7th Cir. 1994) (quoting *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 185 (1973)); *see also Burditt v. Department of Health & Human Servs.*, 934 F.2d 1362, 1375 (5th Cir. 1991); *Woodard v. United States*, 725 F.2d 1072, 1077 (6th Cir. 1984). The Fourth Circuit has similarly stressed that "[a]n administrative agency is entitled to considerable deference in selecting . . . remedies to enforce the policy of a statute it administers." *Doolin Security Savings Bank, F.S.B. v. FDIC*, 53 F.3d 1395, 1408 (4th Cir.), *cert. denied*, 116 S. Ct. 473 (1995). The law is the same in the Eighth Circuit. *See, e.g., Brickner v. FDIC*, 747 F.2d 1198, 1203 (8th Cir. 1984) ("Administrative agencies have considerable latitude to shape their remedies within the scope of their statutory authority.") (internal quotation omitted).

Several courts of appeals, moreover, have applied these standards to rulings that are indistinguishable from the one at issue here. Thus, in *Southern Natural Gas Co. v. FERC*, 813 F.2d 364 (11th Cir. 1987), the court of appeals reviewed a FERC decision that, like this one, involved a determination of whether equitable factors justified limiting a refund award. In affirming the Commission's judgment not to limit refunds in that instance, the Eleventh Circuit emphasized that, in deciding upon a remedy, " 'the ultimate balance of equitable consideration[s] is committed to the Commission's discretion.' " *Id.* at 368 (quoting *Gillring Oil Co. v. FERC*, 566 F.2d 1323, 1326 (5th Cir.), *cert. denied*, 439 U.S. 823 (1978)). Accordingly, the court explained, its role was limited to deciding "whether the agency's [determination was] so unreasonable as to constitute an abuse of discretion." *Id.* at 369.

The Fifth Circuit's precedent is to the same effect. That court has made clear that FERC has "broad discretion to fashion a remedy"; it thus upholds such Commission determinations so long as they are "rational[] and reasonabl[e]." *Transcontinental Gas Pipe Line Corp. v.*

FERC, 998 F.2d 1313, 1324 (5th Cir. 1993); *see also Estate of French v. FERC*, 603 F.2d 1158, 1163 (5th Cir. 1979) (court's review of refund decision is "limited to ascertaining whether there is a rational basis for the agency's determination") (citing *Texas Eastern Transmission Corp. v. FPC*, 414 F.2d 344, 349-50 (5th Cir. 1969), *cert. denied*, 398 U.S. 928 (1970))); *Gillring Oil Co. v. FERC*, 566 F.2d at 1326 (upholding FERC refund decision on the ground that agency "did not abuse its discretion"). That is the rule in the Third Circuit as well. *See Gulf Oil Corp. v. FPC*, 563 F.2d 588, 608 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978).

There is nothing about this case to suggest that these courts would have applied a different standard of review here. As we noted at the outset, the NGPA does not cabin the Commission's remedial discretion. No provision *requires* FERC to award refunds; indeed, unlike some statutes, no provision even expressly *authorizes* the agency to award refunds. Instead, FERC derives both its remedial authority *and* its remedial discretion from the Act's general provision empowering the Commission to "perform any and all acts . . . as it may find necessary or appropriate to carry out its functions" under the statute. 15 U.S.C. § 3411(a).[6]

Nor does section 110 of the NGPA, the substantive provision relevant to this case, demonstrate any congressional intent to divest the agency of its normal remedial discretion. On the contrary, the court below recognized that Congress expressed *no* clear intent through that provision, but rather delegated to the Commission the authority to make the policy judgments necessary to apply it. The court explained that, "[i]n their application to a particu-

[6] Indeed, the D.C. Circuit itself has recognized that a Natural Gas Act provision (15 U.S.C. § 717*o*) that is identical to the NGPA section quoted above gives the Commission "a great deal of flexibility" and authorizes the Commission to "decline to order any refund at all" in appropriate instances. *Laclede Gas Co. v. FERC*, 997 F.2d 936, 944 (D.C. Cir. 1993).

lar state tax, [the relevant terms of section 110] may be ambiguous"; "[p]lainly . . . our standard of review is that of *Chevron* step two" (under which the court defers to a reasonable reading of ambiguous statutory language). Pet. App. 6a. *See generally Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 843 (1984) ("The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill the gap left . . . by Congress.") (internal quotation omitted).[7]

2. Application of the standard of review applied by these other courts would have resulted in affirmance of FERC's refund decision in this case. The Commission explained that requiring refunds for the period before 1988 would be inequitable because the NGPA's language and legislative history, reinforced by the Commission's own post-NGPA rulings, would reasonably have induced parties to believe that the Commission's pre-NGPA Kansas tax ruling remained the law. *See* Pet. App. 51a-53a, 78a-79a. That equitable judgment—grounded in the agency's understanding of the statute it administers and of its own prior decisions, matters on which agencies are normally accorded special deference—was entirely reasonable. Indeed, the belief that the pre-NGPA Kansas tax ruling remained the law even after the NGPA's passage was so deeply ingrained that, in 1983, when Northern Natural petitioned for a ruling that natural gas producers could

[7] Some parties suggested below that 15 U.S.C. § 3413(e)(2)(B) mandated full refunds in this case. That provision, however, has no relevance here. It states that, when a producer charges a new *interim* rate pending the Commission's initial determination of whether the rate comports with specified statutory requirements, the producer may collect the rate subject to refund if the rate is later found to be too high. *See* 15 U.S.C. § 3413(e)(2)(B) (discussing refunds of collections made "pending a determination under this section"). This case, however, involves no such interim rate, nor does it implicate any of the specific statutory requirements with which section 3413 is concerned. *See* 15 U.S.C. § 3413(a)(1).

not recover the cost of the Kansas tax, it specifically requested that the Commission "reopen, reconsider and rescind" the 1974 ruling, thereby acknowledging its continued vitality. C.A. App. 77. And the Commission acted sensibly in concluding that it would be unfair to disrupt these settled exceptions by ordering producers, more than a decade after the fact, to refund hundreds of millions of dollars collected pursuant to the agency's own view of the law.

Other courts of appeals have previously affirmed decisions to limit remedies because of such concerns about the state of the law at the time the private party acted. The Fifth Circuit, for example, concluded that the Commission acted within its wide discretion when it refused to require a company to pay out $26 million in refunds because "market circumstances [at the time the company acted] were confusing and . . . the Commission originally thought schemes like [the one ultimately found unlawful] were acceptable." *Transcontinental Gas Pipe Line,* 998 F.2d at 1323-24. The Third Circuit has similarly determined that FERC acted reasonably when it decided not to award any remedy at all where there had been "widespread misapprehension of the extent of the Commission's jurisdiction" at the time of the conduct at issue. *Borough of Ellwood City v. FERC,* 583 F.2d 642, 647-48 (3d Cir. 1978), *cert. denied,* 440 U.S. 946 (1979).

In fact, other circuits have gone so far as to *reverse* a Commission remedial determination for *failing* to consider the state of the law at the time private parties acted. *See Boston Edison Co. v. FERC,* 856 F.2d 361, 373 (1st Cir. 1988) (reversing refund decision where the Commission, for the first time, overrode a contractual provision limiting remedies; it would be "demonstrably unfair" to impose retroactive refunds on the basis of this "sudden, unforeseeable shift in the prevailing regulatory winds"); *Southwestern Public Service Co. v. FERC,* 842 F.2d 1204, 1207-09 (10th Cir. 1988) (reversing a

FERC refund order based on retroactive application of a new accounting method; emphasizing company's "good faith reliance" on understanding that it could use the old accounting method).

Given these decisions, it is beyond serious dispute that FERC's decision to award only partially retroactive refunds would have been affirmed by any of the Circuits that review such decisions under a deferential abuse-of-discretion standard.[8]

3. The D.C. Circuit, however, followed a very different path. Instead of engaging in the deferential review mandated by decisions in other Circuits, it expropriated the role that Congress entrusted to the agency by undertaking an independent, *de novo* analysis of the refund issue. The court decided on its own that "detrimental reliance" was the lone "crucial point" in determining what remedy was appropriate here. *See* Pet. App. 23a. It then reviewed the record independently to determine whether there was evidence establishing such "detrimental reliance" —which it defined as evidence showing not only that producers actually passed through the Kansas tax, but also that they would have made *other* specific pricing or investment decisions differently had they known of the Commission's new interpretation at the time they acted. *See id.* And, finally, the court mandated a specific remedial result without so much as a remand to allow the Com-

[8] Although the producers argued before the court of appeals that the Commission should have made its decision entirely prospective (an argument that they do not pursue here), they did not question the agency's discretion to craft an equitable remedy. The producers advanced only the limited argument that the Commission was mistaken in concluding that the D.C. Circuit's 1988 remand for further explanation put them on notice that the Commission's prior rulings could no longer be relied upon. In their separate brief as intervenors in support of the Commission, the producers argued that, if the court disagreed with their position on the question of notice, the remedial balance struck by the Commission was well within its broad remedial discretion and should be affirmed.

mission to reweigh the relevant equitable factors in light of the panel's opinion. *See id.* at 24a.[9]

The Commission's understanding of the proper remedial balance had no place in the court's *de novo* inquiry. The court of appeals did not refer to the Commission's reasoning in conducting its analysis, and it certainly did not purport merely to be deciding whether the agency's judgment was a reasonable one. Instead of focusing on whether the agency acted rationally in determining that producers' settled expectations based on then-current law counseled for a partially retroactive remedy, the court ignored the Commission's analysis and focused on a different factor—"detrimental reliance"—which it believed was the only relevant issue here. And when the court finally did address the state of the law at the time the producers acted, it did not even mention—much less defer to—the Commission's understanding of the effect that the NGPA and the Commission's prior case law had no producers' reasonable expectations. Without explanation, the court simply (and incorrectly) proclaimed that the "enactment of a substantially new regulatory regime in 1978 undermined any assurance that the FPC's treatment of the Kansas tax . . . would withstand scrutiny under the NGPA." *Id.*[10]

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[9] The D.C. Circuit's mandating of a specific result itself conflicts with the decisions of this Court and other courts. It has long been a "guiding principle" that "the function of the reviewing court ends when an error of law is laid bare"; at that point, the case must return to the agency for further action because only the agency, not the court, has been charged with responsibility for implementing and administering the statutory policies. *FPC v. Idaho Power Co.*, 344 U.S. 17, 20 (1952); *see also Bridge v. United States Parole Comm'n*, 981 F.2d 97, 105 (3d Cir. 1992); *Thompson v. Department of Labor*, 885 F.2d 551, 558 (9th Cir. 1989).

[10] Nor did the court provide any explanation for its related suggestion that, even after FERC had twice relied on its pre-NGPA Kansas tax ruling in interpreting the new statute, the Commission's position was stripped of reliability as soon as it was "drawn into question" (Pet. App. 24a), not by the agency

The D.C. Circuit never explained why it failed to apply the deferential standard of review applied by other courts.[11] There is no plausible justification. As noted above, the conflict between this decision and the rulings of other circuits cannot be explained away by focusing on the statutory context in which this dispute arose. The NGPA contains no language restricting FERC's ordinary discretion to determine an appropriate remedy, and the D.C. Circuit's opinion did not suggest otherwise. Indeed, the D.C. Circuit's "detrimental reliance" analysis would make no sense if the court had understood the NGPA to deprive FERC of all remedial discretion. In that case, the Commission would be required to award refunds whether or not there had been any "detrimental reliance."

Nor does the court's reference to principles of retroactivity (Pet. App. 18a) justify its failure to defer to FERC's remedial judgment. As the Commission explained (Pet. App. 75a), the question here is not simply whether its newly announced conclusion concerning the Kansas tax should apply to this case; it is also, and more fundamentally, to what extent producers should be required to refund amounts previously collected pursuant to the Commission's explicit prior rulings. The Commission correctly determined that it is entitled to a "wide latitude of discretion" in making just such remedial determinations. *Id.*[12]

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itself, not by a reviewing court, but merely by a single disgruntled party requesting that the Commission *overrule* its prior decision.

[11] Previous cases had suggested that deference was the rule in the D.C. Circuit as well. *See Public Service Comm'n v. Economic Regulatory Admin.*, 777 F.2d 31, 36-38 (D.C. Cir. 1985) (Ruth B. Ginsburg, J.). This decision, however, indicates that the court's current approach is quite different.

[12] As the D.C. Circuit implicitly recognized, this Court's recent decisions in *Reynoldsville Casket Co. v. Hyde*, 115 S. Ct. 1745 (1995), and *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86 (1993)—which require full retroactivity in the *judicial* context on the basis of Article III considerations—do not apply to the rulings

In the end, therefore, there is simply no basis to distinguish this case from the many decisions discussed above in which other circuits have applied highly deferential standards of review to agency remedial judgments just like this one. Because the D.C. Circuit's application of *de novo* review was outcome-determinative in this case, the decision creates a square circuit conflict on a matter of recurring importance.

4. The decision also has important repercussions for the structure of administrative decisionmaking. Even apart from the severe dislocations that will be caused by the D.C. Circuit's imposition of as much as half a billion dollars in potential refund liability, the decision marks a significant and unauthorized redistribution of power within the federal system from the Executive Branch to the Judicial Branch. Under the D.C. Circuit's ruling, it is the court of appeals, *not* the agency, that has the primary role in deciding on the remedy that is appropriate in a particular case. The holding thus deprives agencies of one of the core elements of their congressionally delegated authority to administer regulatory regimes.

Equally important, the decision prevents agencies from providing private parties with reliable guidance concerning their statutory obligations. As the result here demonstrates, under the D.C. Circuit's holding not even an agency's express interpretive ruling can protect a party from staggering and unexpected refund liability many years after the fact. Despite the Commission's explicit rulings authorizing producers to pass through the Kansas tax, the court of appeals held that producers proceeded entirely at their own jeopardy, just as if the agency had provided no authoritative guidance at all. The decision

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of an administrative agency. *See Laborers' Int'l Union v. Foster Wheeler Energy*, 26 F.3d 375, 386 n.8 (3d Cir. 1994) (concluding that *Harper's* rule of full retroactivity does not control in the agency context).

thereby undermines the Commission's future credibility and impairs its ability to achieve important statutory objectives by the exercise of its interpretative authority.

This Court should grant certiorari to forestall these negative consequences and to resolve the circuit conflict on this important issue of administrative law.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued January 12, 1996 Decided August 2, 1996

No. 94-1418

PUBLIC SERVICE COMPANY OF COLORADO, *et al.*,
Petitioners

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

OXY USA INC., *et al.*,
Intervenors

Consolidated with
94-1481, 94-1489, 95-1138

On Petitions for Review of an Order of the
Federal Energy Regulatory Commission

Before: WILLIAMS, GINSBURG and SENTELLE, *Circuit Judges.*

Opinion for the Court filed by *Circuit Judge* GINSBURG.

Concurring Opinion filed by *Circuit Judge* SENTELLE.

GINSBURG, *Circuit Judge*: Until 1993 the Natural Gas Policy Act (NGPA) established the maximum lawful price

that a producer could charge its pipeline customers for natural gas; under § 110 of the Act, the producer could adjust that price upward in order to recover its payment of a state severance tax. The Federal Energy Regulatory Commission, on remand from our decision in *Colorado Interstate Gas Co. v. FERC,* 850 F.2d 769 (1988), held that *ad valorem* taxes levied by Wyoming and Colorado are, but the *ad valorem* tax levied by Kansas is not, a severance tax within the meaning of § 110. The Commission then ordered producers to refund payments received from pipelines in recovery of the Kansas tax with respect to production occurring after the *Colorado Interstate* decision. The Commission directed the pipelines in turn to channel those refunds to their customers, but decided not to make the pipelines liable for any amounts not received from producers.

Petitioner Public Service Company of Colorado and a subsidiary (jointly PSCC), supported by the Missouri Public Service Commission (MPSC) as an intervenor, challenge the Commission's authority to limit the retroactivity of the producers' liability for refunds of the Kansas tax. As a petitioner the MPSC also objects to the Commission's order relieving Williams Natural Gas Company of any obligation to guarantee the refund of the Kansas taxes that Williams collected from its customers, as to which Williams intervenes in support of the FERC, and to the Commission's decision that the Wyoming and Colorado taxes are severance taxes.

Four producers petition for review of the Commission's decision that the Kansas tax is not a severance tax. These Producer Petitioners also maintain that the FERC's decision worked a change in the law that should be applied prospectively only. As Producer Intervenors the same group argues in the alternative that the Commission properly limited their liability for the refunds of the Kansas tax to the date of the *Colorado Interstate* decision. Joined by

another producer, the five so-called Indicated Producers intervene in support of the Commission regarding the Wyoming and Colorado taxes.

We conclude that the Commission could properly determine that the Kansas *ad valorem* tax was, and that the Colorado and Wyoming *ad valorem* taxes were not, sufficiently similar to a severance or production tax to qualify for recovery under § 110 of the NGPA. Contrary to the Commission, however, we hold that the producers must refund all the Kansas taxes they collected since October 1983 when all interested parties were first put on notice that the taxes might not be recoverable under § 110. On the question whether Williams should be required to guarantee the refunds due from its producers to its customers, we find no ground upon which to require that the FERC hold the pipeline liable.

I. Background

From 1978 until 1993 producer prices for natural gas were subject to maximum lawful levels specified in the NGPA. 15 U.S.C. §§ 3311-19. Section 110 of the NGPA permitted a producer to charge an amount in excess of those ceilings to the extent necessary to recover its payment of "State severance taxes attributable to the production of such nautral gas," 15 U.S.C. § 3320(a)(1). For this purpose, a severance tax was defined as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas" by a state or Indian tribe, 15 U.S.C. § 3320(c).

In *Sun Exploration and Production Co.*, 36 FERC ¶ 61,093 (1986), the Commission determined that the Kansas *ad valorem* tax qualified as a severance tax under § 110 because it was based upon production factors. In *Colorado Interstate* we concluded that the Commission's analysis in *Sun Exploration* "fell short of reasoned decisionmaking," and we remanded the matter for a more "cogent

theory of what makes a tax 'similar' to a production or severance tax under § 110." 850 F.2d at 770, 773. Reflecting our indulgent standard of review for a question so bound up in administrative policy-making, we noted that while the court "cannot defer to a vacuum," we would defer to "any Commission interpretation of § 110 that is not precluded by the statutory language and traditional methods of statutory construction, and that is reasonable." *Id.* at 774.

We also offered the Commission some guidance. A severance tax is a cost imposed upon producing, while a property tax is a cost imposed upon holding, a resource; the non-recoverability of a severance tax is a disincentive to produce, while the non-recovery of a property tax is not a disincentive and, to the extent that extraction reduces the value of the reserves to which the property tax is applied, might even be an incentive to produce. *Id.* at 771. On the other hand, if in computing the value of a property for the purpose of levying a property tax "a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." *Id.* at 772.

Upon remand, the Commission identified two essential differences between a severance tax and a property tax:

> First, a . . . severance tax is *on* the volume or value of the commodity *removed,* as assessed at the time of removal. A property tax . . . is on the value of the gas remaining in the ground as well as on the value of wells and other production assets on the lease, at the time of the tax assessment.
>
> Second, . . . once the unit of gas is produced and the severance tax is applied to it, that unit of gas is never again subject to the severance tax. On the

> other hand, a property tax . . . is applied to a unit of gas reserves each year—year after year—until that unit of gas finally is produced and removed from the property being valued.

Colorado Interstate Gas Co., 65 FERC ¶ 61,292 at 62,370-71 (1993) (emphases in original) (hereinafter *Colorado Interstate Remand Order*), *reh'g denied*, 67 FERC ¶ 61,209 (1994) (hereinafter *Colorado Interstate Rehearing Order*). Applying these distinctions, the Commission concluded that the Kansas tax did not qualify as a severance tax for three principal reasons: (1) it was based upon the value of the gas property rather than upon its current production; (2) the volume of production was relevant principally for determining the present value of the gas reserves; and (3) the reserves were taxed year after year until removed from the ground and sold. *Id.* at 62,371-72.

The Commission ordered producers to refund the Kansas taxes they had collected since June 1988, the date of our *Colorado Interstate* decision which, in the FERC's view, first put producers on notice that the tax might not be recoverable under § 110. *Id.* at 62,373. The Commission also ordered pipelines to flow-through the refunds to customers as lump sum payments, but the pipelines were not held responsible for guaranteeing payment if a producer failed to meet its refund obligation. *Id.* at 62,374.

Williams, one of the pipelines ordered to refund the Kansas tax, had also collected Wyoming and Colorado *ad valorem* taxes from its customers. In *Williams Natural Gas Co.*, 69 FERC ¶ 61,373 (hereinafter *Williams Order*), *reh'g denied*, 70 FERC ¶ 61,202 (1994) hereinafter *Williams Rehearing Order*), the Commission held that the Wyoming and Colorado taxes qualified as severance taxes under § 110. The Wyoming tax "is assessed on the volume or value of the gas which is produced" and "varies directly, and exclusively, with actual production." *Id.* at 62,408.

The Colorado tax is "assessed only against gas that is severed from the ground." *Id.* at 62,410. Therefore, Williams was not required to refund these taxes to its customers.

II. Analysis

We turn first to the question whether the Commission was reasonable in holding that the Kansas tax was recoverable under § 110. Next we undertake a similar inquiry with respect to the Colorado and Wyoming taxes. Then we examine the date to which refund liability for the Kansas tax extends; and finally we review the FERC's decision not to hold Williams responsible as a guarantor in the event that a producer does not meet its refund obligation.

A. The Kansas Tax

Our review of the Commission's interpretation of § 110 of the NGPA is governed by the familiar analysis of *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984): if the Congress has "directly spoken to the precise question at issue," the court "must give effect to the unambiguously expressed intent of Congress"; otherwise the court will defer to the administering agency's interpretation if it is reasonable in light of the structure and purpose of the statute. *Id.* at 842-43. In this instance, recall that § 110 of the NGPA permits a producer to "recover . . . State severance taxes attributable to the production of . . . natural gas and borne by the seller," 15 U.S.C. § 3320(a)(1), and that a severance tax is defined as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." 15 U.S.C. § 3320(c). In their application to a particular state tax, any or all of the terms "attributable to the production," "similar," or "other levy," and "imposed on the production" may be ambiguous. Plainly, as the Producer Petitioners acknowledge, our standard of review is that of *Chevron* step two.

The Kansas tax is levied primarily upon the value of recoverable reserves and secondarily upon the value of gas well equipment and materials. In estimating the volume of reserves, the volume of current production is an important factor; therefore, because the tax is partly dependent upon production, the Producer Petitioners allege that it is similar to a production tax.

In remanding *Colorado Interstate* we instructed the Commission to come up with a "cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." 850 F.2d at 773. The agency's determination was to hinge upon "how the specific rules of the tax actually function." *Id.* at 774. According to the Producer Petitioners, however, the Commission responded largely by ignoring the practical application of the Kansas tax and its actual effect upon production incentives, and focused instead upon mere labels.

The principle advanced by the Producer Petitioners is that "a tax whose assessment is measurably affected by a change in the level of production is at least in part attributable to, and effectively imposed on, the production itself." The Petitioners remind us that the Federal Power Commission held that the Kansas tax was recoverable under the Natural Gas Act, Opinion No. 699-D, 52 FPC 915, 915-16 (1974), and that the Congress incorporated into § 110 of the NGPA terms virtually identical to those it had used in the prior statute, *see* Opinion No. 699, 51 FPC 2212, 2301, *reh'g denied in relevant part*, 52 FPC 1604 (1974), *aff'd sub nom. Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975)—which suggests that the Congress intended no significant contraction in the range of severance taxes that could be recovered. Indeed, the Conference Committee Report on § 110 states that the term "severance tax" should be "construed broadly" and may extend to "any tax imposed upon mineral or natural resource production including an ad valorem tax or a gross receipts tax." H.R. CONF. REP. No. 95-1752, 95th Cong., 2d Sess. 91 (1978).

The two characteristics of a tax recoverable under § 110, in the view of the Producer Petitioners, are that its calculation is directly related to the rate of current production and that its non-recovery would operate as a disincentive to produce. It is not necessary that the tax be attributable exclusively to production, nor that it be computed in the same manner as a severance or production tax; it is enough that the assessed liability be to some extent "attributable to the production of . . . natural gas." The Producer Petitioners claim that the FERC's interpretation—under which the tax must be (1) laid upon "the act of severing," (2) "each Mcf or MMBtu of gas production," and (3) assessed "at the time of removal," *Colorado Interstate Remand Order*, 65 FERC at 62,370, 62,371—effectively reads the term "similar tax" out of the statute.

Applying their more liberal construction of § 110, the Producer Petitioners contend that the Kansas tax fully satisfies the criteria for recoverability. First, while the tax is also affected by variables other than production, the amount of the tax increases or decreases as production increases or decreases. For example, as between two wells with the same reserves, the one expected to produce more gas will be taxed at a higher level. This argument, however, does little to dispel our understanding that the Kansas tax is by its terms a tax upon property. The value of a depletable asset is a function of its physical and its temporal dimensions; in the case of a gas well, these are respectively the volume of recoverable reserves and the timing of their recovery, which progressively depletes the reserve. The greater the volume of gas produced in a given tax year, the shorter the time over which all the proceeds will be realized and, consequently, the higher the present value of the asset.

The relevant question, therefore, is the obverse of the one suggested by the Producer Petitioners. We do not ask whether two wells with the same reserves would be

taxed differently based upon their different anticipated rates of production; obviously they would be, whether the tax is imposed *ad valorem* upon property or upon production. The value of the reserves would be higher for the well with more rapid production because faster production reduces the time over which the flow of gas is turned into a stream of cash. Instead, we must inquire whether the same tax would be levied upon two wells with different reserves but the same level of production. If the tax is based upon production, then the amount of the tax would be the same; if the tax is based upon property, then the amounts would be different. By this criterion, as we shall see, the Kansas tax is laid upon property, not upon production.

In *Colorado Interstate* we posited that the high initial level of production caused by the pressure in a new well could, when annualized in accordance with Kansas's method of appraisal, yield a higher tax upon a property that started operation late in the year than upon an equally productive property that was in operation for the full year. 850 F.2d at 773. Prompted by that observation, the Producer Petitioners now attempt to explain that the State's use of an annualized figure for production when a new well operates for only part of its first tax year does not relax the relationship between the amount of the Kansas tax and the volume of production. To the contrary, they point out that a 1980 amendment to the Kansas tax law was designed to offset the disproportionately high levy on a well in operation less than six months during the tax year by reducing its appraised value by 40 percent.

Again, the Producer Petitioners' argument supports not their position but the Commission's. As the agency properly observes, an adjustment for the exaggerated level of initial production caused by the high pressure in a new well would be unnecessary if the Kansas tax were indeed based upon production. Any gas produced would be taxed; any gas left in the ground would not be taxed.

Kansas authorized an adjustment precisely because its tax is based not upon production but upon gas in the ground; *i.e.*, the State needed a reliable estimate of "annual" production to use in calculating the present value of recoverable reserves. Otherwise there would have been no need to annualize the partial year's output from a new well.

The Commission gave three reasons for rejecting the "measurably attributable to production" standard suggested by the Petitioners. First, it is just the type of murky standard that this court had criticized in *Colorado Interstate. Colorado Interstate Rehearing Order,* 67 FERC at 61,654. Second, the standard is cumbersome to administer; it requires "virtually well-by-well analysis to ascertain exactly how much weight the state property appraiser gave to current production." *Id.* at 61,654-55. Third, simply providing that a tax be measurably related to production does not distinguish between a severance tax and an array of other taxes—income, personal property, real estate—that could vary "in a more-or-less direct manner with production." *Id.*

What is required, contends the Commission, is that the tax vary "directly" with production on "essentially" a one-to-one basis. *Colorado Interstate Rehearing Order,* 67 FERC at 61,655. Indeed there is some support for that proposition in the history of § 110. In 1974 the Federal Power Commission interpreted the Natural Gas Act to allow recovery of the Kansas tax. Opinion No. 699-D, 52 FPC at 915-16. As we observed in *Colorado Interstate,* however, when the Congress enacted § 110 it supplemented the FPC's formula for recovery ("all . . . production, severance, or similar taxes," Opinion No. 699, 51 FPC at 2301) with the added requirement that the tax be "imposed on the production of natural gas." 850 F.2d at 772. That new qualification is the basis upon which the Commission argues for a one-to-one relationship between the volume of production and the amount of the tax.

The Kansas tax, according to the FERC, is a property tax levied upon the value of recoverable reserves, gas well equipment, and materials, *id.* at 62,374; current production is only a "yardstick by which the value of the leasehold is measured," *id.* at 62,371-72. The appraised value of the reserves depends upon the estimated future production of the well (as determined in part by actual production over the most recent three- or five-year period) and market prices, reduced by operating costs, all forecasted over the probable period of production and discounted to present value. *See Colorado Interstate,* 850 F.2d at 771. Because of differences in the anticipated rate of production and in the estimated quantity of reserves, the tax upon two wells producing the same volume of gas may "vary nearly by a factor of ten." *Id.*

At oral argument, we asked counsel for the Producer Petitioners whether in practice the tax on a well varies over time in direct relation to the well's production. If not, the tax could not properly be characterized as being based upon production. Because the answer to this question has important implications, we take a moment to examine the mechanics of the tax calculation in somewhat greater detail.

The value of recoverable reserves, for the purpose of the Kansas tax, is based predominantly upon the value of the well's average production multiplied by a "present worth factor." The present worth factor, in turn, depends upon the estimated quantity of the reserves, the time value of money, the expected rate of change in the price of gas, and the expected rate of change in production. The Kansas Department of Revenue promulgates a present worth factor for use in valuing all properties in a major proven gas field. Assuming that the Department determines present worth factors *ex ante* and does not revise them periodically, then the only variable affecting the annual appraisal of a well is the value of the well's production. Under these circumstances, the Kansas tax

would, in our view, be sufficiently like a tax "imposed on the production of natural gas" to be recoverable under § 110. Although the tax is called an *ad valorem* tax and calculation of the tax is based upon the present value of recoverable reserves, any change in the amount of the tax due would depend in practice entirely upon a change in the value of production from year-to-year.

The question, therefore, becomes whether there is a change over time in the present worth factor for a particular well or field. If so, then the tax will depend upon the magnitude of that change (and upon any variation in production, of course). In fact, because increased production diminishes the remaining recoverable reserves, and thus typically reduces the anticipated life of a well, periodically updating the present worth factor could yield a tax that is completely unrelated to, or even negatively correlated with, production. Counsel for the Producer Petitioners was not able to refer us to any evidence in the record indicating that the present worth factor for a single field remains constant over time. Therefore, the Petitioners could not show that the Kansas tax necessarily varied in direct relation to production.

Because the Producer Petitioners bear the burden of showing that the Commission's analysis of the Kansas tax is unreasonable, their inability to demonstrate that the present worth factors are invariant over time could have been an end to the matter. Nonetheless, we searched the record independently—but the result was only to increase our confidence that variables other than production can have a material impact upon the tax assessed. Tables captioned "Major Proven Gas Areas and Fields" show a substantial change in the present worth factor for certain fields over the three years from 1986 to 1989. Indeed, the prevailing pattern is for the present worth factor to decline with the passage of time, which is what we would expect. As the anticipated life of a well declines, the present value of the recoverable reserves decreases corre-

spondingly; that is consistent with our hypothesis that higher production foreshadows a diminished remaining life, which in turn can result in not a higher but a lower tax.

There is more. One appraiser for the Kansas Department of Revenue has identified seven factors other than current production that he considers in determining the present value of reserves: age of the well; quality of the oil and gas; nearness to market; operating costs; character, extent, and permanency of the market; probable life of the well; and the number of other wells being operated. Furthermore, Kansas assesses the tax upon each physical unit of reserves, year after year until the unit is produced. In order to qualify as a severance or production tax under § 110, however, a physical unit must be taxed only once —at the time of production. *Colorado Interstate Remand Order*, 65 FERC at 62,371. The Commission also observes that a typical well in the Permian Basin, roughly 2800 feet deep, will be appraised at a value that includes $56,000 for equipment alone, *i.e.*, exclusive of the value of any gas reserves. Even after a well has been shut-in for two years the equipment on a "normal" well is valued at $4,200. If the Kansas tax were based upon production, then there would be no tax on a non-producing well.

Singly and cumulatively, the Commission's arguments are convincing and neither of the Producer Petitioners' two principal contentions persuade us otherwise. First, the Producer Petitioners contend, mistakenly, that non-recovery of a property tax based in part upon production operates as a disincentive to produce and thus defeats a primary objective of the NGPA. If the present value of reserves is computed by the Kansas formula, then (other things being equal) the higher the tax rate the greater the incentive to produce. Although higher production is a factor tending to increase the Kansas tax this year, it reduces the expected future production from the well, a factor tending to decrease the Kansas tax in all

future years. The tax-reducing effect of decreased life expectancy will almost always exceed the tax-increasing effect of higher production.* In short, if demand is inelastic (as it would be when the ceiling is well below market price), a recoverable tax would have little effect upon production at the margin; but a non-recoverable tax would be an incentive to extract gas more rapidly in order to minimize the impact of the tax.

Second, the Petitioners advance the theory (in their Reply Brief) that "a tax qualifies for reimbursement under § 110 . . . if production is a factor in the calculation." By that standard, an ordinary property tax would qualify as a tax on production; the value of any asset is, after all, the present worth of the benefits that the asset is expected to produce—whether impounded in an established market price or estimated by an appraiser. The Commission reasonably declined to adopt a standard —overbroad, administratively cumbersome, and almost infinitely elastic—with so little to recommend it.

Weighing the various arguments—and mindful that as we said in *Colorado Interstate*, "any Commission interpretation of § 110 that is not precluded by the statutory language and traditional methods of statutory construction, and that is reasonable, will control," 850 F.2d at 774—we conclude that the FERC's interpretation of § 110 of the NGPA is reasonable. Furthermore, applying

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* Suppose, for example, a well with 1,000 Mcf of reserves at year-end 1995 is taxed at the rate of $1 per Mcf remaining on December 31 of each year. The producer would have an incentive to deplete the well as quickly as possible. Production of 500 Mcf on January 1 of both 1996 and 1997 would mean tax assessments of $1,000 and $500 on December 31 of 1995 and 1996 respectively. By comparison, production of 250 Mcf on January 1 of each year from 1996 through 1999 would mean tax assessments of $1,000, $750, $500, and $250 on December 31 of each year from 1995 through 1998—and a much higher total tax. (This assumes of course that the estimated volume of reserves does not change from year to year except to account for the previous year's production.)

that interpretation, the Commission reasonably determined that the Kansas *ad valorem* tax is not a severance tax within the meaning of that section.

B. The Colorado and Wyoming Taxes *

The MPSC, while agreeing with the Commission's interpretation of § 110, urges that the FERC incorrectly applied its own criteria when it allowed recovery of the Colorado and Wyoming taxes. In the *Williams Order*, the Commission stated that "the Wyoming *ad valorem* tax qualifies for recovery . . . in that it is assessed on the volume or the value of the gas which is produced rather than upon the value of gas reserves or lease-hold property. Hence, the tax varies directly, and exclusively, with actual production." 69 FERC at 62,408. The Commission adopted the same rationale in deciding that the Colorado tax could be recovered under § 110. *Id.* at 62,410. The MPSC asserts that this rationale conflates a production-based tax with a property tax.

According to the MPSC, the Wyoming and Colorado taxes are based upon proceeds, not upon production. Taxing authorities administer a proceeds tax as they do a property tax: the underlying property is placed on both state and local tax rolls and aggregated with other prop-

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* The Indicated Producers claim that the MPSC is barred from contesting the Colorado and Wyoming taxes because the MPSC was some hours late in filing its request for rehearing the *Williams Order*. The FERC, however, waived the 30-day limit in the NGPA, 15 U.S.C. § 3416(a)(2), and accepted the MPSC request as timely filed, *Williams Rehearing Order*, 70 FERC at 61,633. The Indicated Producers argue that the FERC had until then consistently treated the 30-day limit as a jurisdictional requirement that it could not waive. The MPSC replies that the Indicated Producers failed to request rehearing of the Commission's decision to waive the time limit, and thereby failed to preserve the issue for judicial review. We agree. *See* 15 U.S.C. § 3416(a)(4) (no judicial review unless issue raised before agency in application for rehearing). We proceed therefore to address the question whether the Colorado and Wyoming taxes were recoverable under § 110.

erty to determine the appropriate state and local *ad valorem* tax rates. A production tax, by contrast, is a state-wide levy subject to a single state-wide rate, administered by and for the benefit of the state and not of the locality. The MPSC contends that the Wyoming and Colorado taxes differ from a typical property tax only in that they grant a preference to natural gas property over other types of property. In Wyoming, the preference arises by taxing gas property only once, which is to say when the gas is extracted. In Colorado, gas reserves are taxed annually but their value is assumed to equal a specified percentage of the value of the prior year's production. Otherwise, according to the MPSC, the Wyoming, Colorado, and Kansas taxes are similar and ought to be treated similarly under § 110; the Wyoming and Colorado legislatures may be free to favor gas producers over other property owners, but the Congress did not intend to favor gas producers in states with a tax based upon proceeds over gas producers in states that impose upon them a traditional property tax.

The Commission responds, first, that the Wyoming *ad valorem* tax meets the criteria set forth in the *Colorado Interstate Remand Order* and applied in the *Williams Order*, 69 FERC at 62,408. The tax is assessed upon the volume of gas removed from the well, Wyo. Stats. § 39-2-208; payable "one time only . . . as a result of production," *Union Pac. Resources Co. v. State*, 839 P.2d 356, 372 (Wyo. 1992); and based upon the "full value" of the gas when produced, *id.* at 372 n.7. Second, that the tax may benefit local taxing units is not pertinent; a tax imposed "by any political subdivision of a State" is recoverable under § 110. 15 U.S.C. § 3320(c)(2). Third, as this court has recognized, "a tax nominally on property may be functionally identical to a production tax," *Colorado Interstate*, 850 F.2d at 772. Fourth, a tax need not be labeled a "severance tax" in order to be "recoverable" within the meaning of § 110; the term "severance tax" is

to be "construed broadly," and may include an *ad valorem* tax, H.R. CONF. REP. No. 95-1752 at 91, as well as any "similar tax, fee, or other levy imposed on the production of natural gas," 15 U.S.C. 3320(c).

Finally, the Commission argues that administrative differences between a tax based upon production and an *ad valorem* tax are irrelevant to the question whether the tax may be recovered under § 110. Indeed, Wyoming has a separate severance tax, which no one here doubts is recoverable within the meaning of § 110. In distinguishing that tax from the state's *ad valorem* tax based upon proceeds, the Wyoming Supreme Court observed: "[T]he severance tax is an excise tax upon the current and continuing privilege of extracting minerals. . . . An ad valorem tax is a property tax which taxes the value of the minerals produced." *Wyoming State Tax Comm'n v. BHP Petroleum Co., Inc.*, 856 P.2d 428, 434 (1993). This characterization of the Wyoming *ad valorem* tax supports the Commission's conclusion that it is based upon production.

Colorado, too, imposes a severance tax in addition to an *ad valorem* tax. The Indicated Producers point out, however, that 87.5% of the *ad valorem* tax may be taken as a credit against the severance tax. This, say the Indicated Producers, proves that the two taxes are "directed at the same activity and intended to accomplish the same purpose, *i.e.*, to tax production as it occurs." Moreover, as the Tenth Circuit noted—albeit in the course of determining whether the Colorado tax is a real estate or personal property tax, not whether it is sufficiently similar to either a severance or other production-related tax to be recovered under § 110—"[p]ast production is used in the Colorado ad valorem tax system only as a gauge for the valuation of the mineral interest. Use of this admittedly imperfect gauge does not rule out the conclusion that the mineral interest itself is being taxed." *Federal Land Bank of Wichita v. Board of County Comm'rs*, 788 F.2d 1440, 1442 (1986).

The Commission nonetheless argues persuasively that the Colorado *ad valorem* tax "varies directly with production" and is "assessed only against gas that is severed from the ground." *Williams Order,* 69 FERC at 62,410. The irreducible fact is that the tax is computed as a set percentage of the market value of the gas removed from a well during the tax year. Colo. Rev. Stat. §§ 39-7-101 and 39-7-102. As we stated in *Colorado Interstate*: When computing the value of property, "[i]f a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." 850 F.2d at 772. That is precisely how the Colorado tax is computed.

In sum, the clear weight of the arguments supports the Commission's determination. Both the Colorado and Wyoming *ad valorem* taxes are based upon production and as such may be recovered under § 110 of the NGPA.

C. Retroactivity

Next we take up the question whether the Commission properly ordered producers to refund Kansas taxes recovered since, and only since, our *Colorado Interstate* decision in June 1988. The governing principle is that when there is a "substitution of new law for old law that was reasonably clear," the new rule may justifiably be given prospectively-only effect in order to "protect the settled expectations of those who had relied on the preexisting rule." *Williams Natural Gas Co. v. FERC,* 3 F.3d 1544, 1554 (D.C. Cir. 1993). By contrast, retroactive effect is appropriate for "new applications of [existing] law, clarifications, and additions." *Id.* The Commission concluded that "[t]he 'settled expectations of those who had relied on the preexisting rule' . . . were changed by the [court's June 1988] *Colorado Interstate* decision, not really [by the FERC's] own decision" in the

1993 *Colorado Interstate Remand Order,* 65 FERC at 62,373.

The Producer Petitioners maintain that the Commission did indeed substitute a new rule for a reasonably clear old rule when, in the *Remand Order,* it first refused to let them recover the Kansas tax. Our decision in *Colorado Interstate,* the Petitioners point out, was a remand, not a reversal, of the Commission's decision in *Sun Exploration* allowing producers to recover the tax. The court directed the Commission only "to exercise its interpretive authority, to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently." 850 F.2d at 775. We did not indicate that we expected a particular result, and consequently we did not disturb the settled expectations of producers who were relying upon the old rule. Upon this view of the matter, it was precisely the Commission's ruling in the *Remand Order* that did change the governing law; prior to that decision, the Petitioners contend, they did not have reason to anticipate that the Commission would change the rule. As they point out, that the agency had not previously engaged in reasoned decisionmaking did not mean that it could not reasonably reach the same result upon remand. Accordingly, the Producer Petitioners argue that their refund liability should extend back not to June 1988 but only to December 1993.

PSCC, on the other hand, argues that regardless of when the Commission first determined that recovery of the Kansas tax was unlawful, it necessarily had been unlawful since the NGPA was enacted in 1978. After first arguing before the Commission for full retroactivity back to 1978, however, PSCC conceded that "fundamental fairness . . . [dictates] that the date on which interested parties were put on notice of the dispute should control the date of retroactivity." Request for Rehearing, *Colorado Interstate Gas Co.,* Dkt. Nos. GP83-11-003 and RI83-9-004, at 6

(FERC Jan. 3, 1994). Therefore, suggested PSCC, liability for refunds should extend back at most to August 1983, when Northern Natural petitioned the Commission for a determination that the Kansas tax was not recoverable under § 110, or at least to October 1983, when all interested parties received notice of the petition by publication in the Federal Register. *Id.* at 4.* As between the two, the later date is obviously the correct one. *See Associated Gas Distribs. v. FERC*, 899 F.2d 1250, 1256 (D.C. Cir. 1990) (FERC gives notice of petition by publication in Federal Register).

To recapitulate, the various parties now urge that when the Commission issued its *Colorado Interstate Remand Order* in December 1993, it should have made liability for refunds (per the Producer Petitioners) prospective-only; (per the Commission) retroactive to June 1988, when we issued our decision in *Colorado Interstate*; or (per PSCC) retroactive to October 1983, when notice of Northern Natural's petition to disallow recovery of the Kansas tax was published in the Federal Register.

PSCC, the MPSC, and the Commission all argue against prospective-only application. By December 1993 gas at the wellhead was no longer subject to a maximum lawful price; deregulation had rendered § 110 moot almost a year before. *See* Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157. Accordingly, producers would have no liability under a rule that limited refunds to taxes paid on post-December 1993 production. Their point seems to be that customers should not lose

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* The MPSC argues for full retroactivity back to 1978, but we agree with the Producer Intervenors that it is precluded from raising that argument before us. The MPSC did not make a retroactivity argument in its request for rehearing before the FERC, and it does so here only as an intervenor, not as a petitioner. *See Illinois Bell Tel. Co. v. FCC*, 911 F.2d 776, 786 (D.C. Cir. 1990) ("An intervening party may join issue only on a matter that has been brought before the court by another party").

their entitlement to refunds merely because the Commission took five years after our decision in *Colorado Interstate* to issue the *Remand Order*.

The FERC makes a more convincing argument against prospective-only application of its 1993 decision based upon this court's criticism in *Colorado Interstate* of both the logical and the factual bases for the agency's prior policy; that sent a "clear signal" to producers that their recovery of the Kansas tax under § 110 might not be lawful. After that "the parties no longer would have been justified in relying on the Commission's earlier rulings with any assurance that they would not later be required to make refunds." *Colorado Interstate Remand Order*, 65 FERC at 62,373.

The Commission marshals the events leading up to the *Colorado Interstate* remand in further support of this compromise view. As we have seen, under the Natural Gas Act, the Federal Power Commission had held in 1974 that the Kansas tax could be added to the maximum lawful rate. Opinion No. 699-D, 52 FPC at 915-16. Four years later the Congress carried forward into the new NGPA a provision nearly identical to the provision of the NGA that the FPC had earlier applied to the Kansas tax. *See* Opinion No. 699, 51 FPC at 2301. Furthermore, in the legislative history of the NGPA the Congress specifically anticipated that producers might recover an *ad valorem* tax under § 110. H.R. CONF. REP. No. 95-1752 at 91. In 1986 the Commission reaffirmed that the Kansas tax was recoverable under that section. *See Sun Exploration*, 36 FERC ¶ 61,093. Not until our 1988 decision in *Colorado Interstate*, remanding *Sun Exploration*, was there any official suggestion that the law might be otherwise. Finally, in 1993 the Commission effectuated a change in the law by developing new standards for determining whether a tax may be recovered under § 110. Thus, according to the Commission, the producers had no indication that the rule might be any different until our *Colorado Interstate* deci-

sion in 1988, and requiring them to refund taxes recovered with respect to gas produced prior to that date is not justified.

The agency also concludes that requiring refunds back to the date of our decision in June 1988 properly balances the producers' equitable claim to notice against the consumers' legal right to receive a refund of all unlawfully collected charges. On the one hand, prospective-only application of the law would permit producers to retain sums collected from June 1988 to December 1993 in excess of the maximum lawful prices prescribed in the NGPA—without any supporting rationale. On the other hand, a fully retroactive remedy would penalize producers by requiring disgorgement of sums they innocently collected prior to June 1988—even though our 1988 *Colorado Interstate* decision was the first authoritative indication that the Kansas tax might not be recoverable after all.

In support of making the Commission's decision retroactive to 1983, PSCC offers a different account, or at least one with a different emphasis, of the transition from the NGA to the NGPA. In this version the key point is that the Commission does not have the expansive remedial powers under the NGPA that it wielded under the NGA, 15 U.S.C. § 717c(e). Specifically, whereas the NGA gave the Commission discretion to order refunds if it determined that a rate was not just and reasonable, the NGPA established maximum lawful prices and gave the customer a right to a refund if it was overcharged.

PSCC also points out that when it issued the *Remand Order* the Commission was not engaged in rulemaking but in adjudicating the rights of the parties before it; therefore the agency was necessarily articulating and giving retroactive effect to existing law. When it is clarifying existing law, rather than substituting new law for old, the agency need not be as attentive "to protect[ing] the settled expectations of those who had relied on the preexisting rule."

Williams, 3 F.3d at 1554. Indeed, as PSCC points out, the producers never explain how their "settled expectations" led them into detrimental reliance upon being able to recover the Kansas tax.

As we see the issue, the apparent lack of detrimental reliance on the part of the producers is the crucial point. What would they have done differently if they had known in 1983 that they were not entitled to recover the Kansas tax? They could not have raised their prices above the maximum lawful level regardless whether the traffic would have borne such an increase. Nor do they contend that existing prices were below the lawful limit; and if they were, price increases might still have been foreclosed by competitive constraints. The producers may have shut in some wells or refrained from exploring for new wells if their inability to recover the tax would have rendered the wells unprofitable, but neither the producers nor the Commission has even suggested these possibilities. All the producers do suggest is that "[a] prudent producer would have cut back on production to the extent that non-recovery of the tax increased [the] current marginal cost of production," Petition of Producer Petitioners for Rehearing of Order on Court Remand, *Colorado Interstate Gas Co.*, Dkt. Nos. GP83-11-003 and RI83-9-004, at 23 (FERC Jan. 3, 1994), but in this they are mistaken; as noted above, the more slowly a well is depleted, the greater the remaining reserves and the higher the tax thereon. Moreover, neither party has even roughly quantified the harm (*e.g.*, the expenditures made and lost in detrimental reliance upon being able to recover the Kansas tax) that the producers might suffer should they have to refund the full amount that they unlawfully collected. In these circumstances, we are hard pressed to see how the producers would be harmed in any cognizable way even if they were required to disgorge every dollar they received in recvery of the tax (assuming any party were seeking such extensive relief).

Not only is the producers' "detrimental reliance" purely notional; if it were real it would not have been reasonable. The enactment of a substantially new regulatory regime in 1978 undermined any assurance that the FPC's treatment of the Kansas tax under the NGA would withstand scrutiny under the NGPA; reliance would have been foolhardy. If that were not enough, the status of the Kansas tax was expressly drawn into question in 1983 when Northern Natural first petitioned the Commission for a ruling that producers could not lawfully recover the tax under § 110. Once the recoverability of the tax was in dispute, we do not see how the Commission could possibly find that producers reasonably relied upon continuing to recover it.

Because no seller of natural gas could justifiably be confident that it was entitled to recover the tax until the legal question was settled anew under the new statute, we hold that the producers' liability for refunds extends back to October 1983, the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under § 110 of the NGPA was at issue, and the earliest date advocated by any party before this court. Absent detrimental and reasonable reliance, anything short of full retroactivity (*i.e.*, to 1978) allows the producers to keep some unlawful overcharges without any justification at all. The court strongly resists the Commission's implication that the Congress intended to grant the agency the discretion to allow so capricious a thing. Still, we do not require refunds of taxes recovered with respect to production before October 1983 because there is before us no controversy over those monies.

D. The Pipeline as Guarantor

In the *Colorado Interstate Remand Order* the Commission required interstate pipelines to "pass through any *ad valorem* tax refunds they receive from first sellers," 65 FERC at 62,374, but made it clear that "pipelines will not

be required to be guarantors of refunds." *Id.* The MPSC, on behalf of the customers of the Williams pipeline, was the only party to challenge that decision. The FERC adhered to its position, however, adding that Willams should not be treated differently than other similarly situated pipelines. *Williams Natural Gas Co.*, Dkt. Nos. TA89-1-43-004 and RP89-39-005, slip op. at 5 (FERC order June 2, 1994), *clarification denied, Williams Order*, 69 FERC ¶ 61,373. The MPSC properly dispatches the FERC's afterthought with the observation that it is routine for one pipeline to be required to make refunds while others are not—because the one is challenged and the others are not.

In its petition for review, the MPSC raises three objections to this aspect of the Commission's decision. First, it observes that under § 4 of the NGA the Commission is authorized to order refunds of any amounts collected from consumers in excess of what is just and reasonable. 15 U.S.C. § 717. Second, the MPSC contends that until the *Colorado Interstate Remand Order* was issued in December 1993, Williams should have understood that when it was allowed to continue collecting from its customers the amount of the Kansas tax "subject to refund," it became conditionally obligated to refund any amount later determined to be unlawful. Indeed, Williams received explicit notice in 1989 that the Commission was considering whether monies collected in recovery of the Kansas tax would have to be refunded. *Williams Natural Gas Co.*, 47 FERC ¶ 61,114 at 61,341. According to the MPSC, this notice should have prompted Williams to take reasonable steps to assure that it could in turn obtain refunds from its suppliers. Third, the MPSC asserts that the Commission should have required Williams to put the monies it received for the Kansas tax into escrow (or post a bond or obtain a letter of credit) in order to assure their return if need be. Escrow arrangements are commonly used when a rate increase is conditionally allowed to take effect until the agency determines whether it is lawful. *See, e.g.*,

Transcontinental Gas Pipe Line Corp. v. FERC, 866 F.2d 477, 479 (D.C. Cir. 1989).

The Commission responds, first, that there is well-established precedent for treating pipelines as mere conduits for the flow of refunds from producers to consumers. *See, e.g., Public Utils. Comm'n of Cal. v. FERC*, 24 F.3d 275, 278 (D.C. Cir. 1994). Second, the FERC explains that accepting Williams' rates "subject to refund" means simply that the agency would order refunds if appropriate after the remand proceedings in *Colorado Interstate*, not that Williams was expected to pay the tax monies into escrow (or take equivalent steps) in order to assure that they would be available if refunds were ordered. Third, the Commission maintains that it could not have directed Williams to set up an escrow arrangement because the pipeline was obligated by contract to pay producers the amount of the Kansas tax. The Commission points to § 601(c) of the NGPA, 15 U.S.C. § 3431(c), which guarantees a pipeline full recovery of its gas purchase costs.

The Commission's arguments are not convincing. Surely Williams' contractual obligation does not extend to paying to producers sums unlawfully recovered. While § 601(c) requires that a pipeline be allowed fully to recover its gas purchase costs, that provision also authorizes the Commission to deny recovery of costs that are unjust or unreasonable. Moreover, the Commission would not have violated § 601(c) by requiring that the taxes be placed in escrow while the agency determined whether they could indeed be recovered under § 110. An escrow arrangement would have preserved the rights of all parties. If the Commission ultimately decided that the taxes were recoverable under § 110, then the producers would be entitled to the amount in escrow, including any accrued interest. If, as happened, the Commission decided that the taxes were not recoverable, then the amount in escrow could have been refunded to the ratepayers (again, with

interest). In either event, the pipelines would have recovered their full gas purchase costs.

Regardless whether the Commission abused its discretion by failing to require an escrow or its equivalent—a matter we need not decide today—the MPSC's petition for review must be denied. Insofar as it seeks prospective relief, the issue is moot: Wellhead prices have been totally deregulated since 1993, there are no longer any maximum lawful prices for producer sales, and whether a producer recovers severance taxes is a matter of negotiation between buyer and seller. As for monetary relief, it is too late now for the Commission to require that Williams pay the severance taxes into escrow; the pipeline has long since paid the monies to the producers.

Nor does the MPSC make out any legal or equitable principle that would suggest holding Williams accountable for the Commission's failure to protect consumers. The pipelines were, as the Commission has reminded us, mere conduits; they had no financial interest in this dispute. The Commission's failure to impose an escrow or other arrangement did not benefit the pipelines, and it is not clear why they should be at risk because the FERC may have been remiss. Nor was Williams obliged either by contract or by regulation to take any precaution against the possibility that a producer would fail to refund monies due to consumers. Therefore, there is no ground upon which the court can say that the Commission was required to hold the pipeline—which was charged first with the task of collecting tax payments and then of distributing tax refunds—liable if the responsible producer defaults on its refund obligation.

III. Conclusion

The Commission's interpretation of § 110 of the NGPA is in all respects reasonable. The Commission properly rejected the Producer Petitioners' proposal that it allow recovery of any tax that was "measurably attributable" to

production. That standard is overbroad and unwieldy, and we criticized it as ambiguous in *Colorado Interstate*. The agency reasonably determined that the Kansas *ad valorem* tax is not a severance tax within the meaning of § 110. The Kansas tax is a function of numerous factors other than production, with the result that producers of equal volumes of gas may be taxed very different amounts; and the tax falls upon each unit of reserves each year, rather than once at the time of extraction. Further, the Producer Petitioners are mistaken in their assertion that non-recovery of a property tax based in part upon production is a disincentive to produce.

The Commission reasonably determined that both the Wyoming and the Colorado *ad valorem* taxes were recoverable as severance taxes under § 110 of the NGPA. The Wyoming tax is assessed upon the volume of gas removed from the well; it is a "one time only" tax, based upon the value of the gas when produced. That the state treats the tax as a property tax is of no moment if, in the terms of § 110, it is "imposed on the production of natural gas." 15 U.S.C. 3320(c). The Colorado tax, also administered as a property tax under state law, is computed as a set percentage of the market value of the gas removed from a well during the tax year. That is "plainly . . . similar enough to a production tax to qualify under § 110." *Colorado Interstate*, 850 F.2d at 772.

Producers are liable to refund all Kansas *ad valorem* taxes collected with respect to production since October 1983. An agency adjudication should be applied retroactively unless new law is replacing clearly defined old law and reasonable reliance interests must therefore be protected. Here the agency did not change the law—rather, the Congress did when it enacted the NGPA in 1978—nor was there any showing that the producers had relied, let alone detrimentally or reasonably relied, upon the continuing validity of the agency's interpretation of the NGA. There is no substantive reason, therefore, to deny

customers all the relief to which they are entitled. The customers are limited, however, to recovery of taxes paid with respect to production since October 1983 because that is the earliest date for which any argument has been preserved in this proceeding for review.

Finally, the court will not require the Commission to make the Williams pipeline a guarantor of the producers' obligation to refund the Kansas tax. Although an escrow arrangement would likely have preserved the rights of all parties, the Commission did not impose one, and no party has pointed to any legal or equitable principle by which the agency can be required to hold a pipeline accountable for the agency's own oversight.

For these reasons, we deny the petitions for review filed by the Missouri Public Service Commission and the Producer Petitioners, and we grant the petition for review filed by the Public Service Company of Colorado.

So ordered.

SENTELLE, *Circuit Judge, concurring*: I join without reservation in the holding of the court. I write separately only to place a little distance between myself and what I deem to be an overstated dictum. After describing a hypothetical tax, the majority states that with the majority's proposed variations "the Kansas tax would, in our view, be sufficiently like a tax 'imposed on the production of natural gas' to be recoverable under § 110." Maj. op. at 11. As no such tax is before us, for us to authoritatively render an opinion on what it would be constitutes nothing less than the advisory opinion that Article III courts have held ourselves unable to render since the earliest days of constitutional jurisprudence. *See, e.g., Flast v. Cohen*, 392 U.S. 83, 96 (1968) ("[T]he oldest and most consistent thread in the federal law of justiciability is that the federal courts will not give advisory opinions." (Internal quotations and citations omitted)); WRIGHT, MILLER & COOPER, 13 FEDERAL PRACTICE AND PROCEDURE § 3529.1 (1984) (detailing the long history of the rule forbidding advisory opinions). We have already, in my view, crossed the line of appropriate Article III jurisprudence in dealing with § 110 tax treatment when the prior panel stated "[i]f a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the [property] tax would plainly be similar enough to a production tax to qualify under § 110." *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769, 772 (D.C. Cir. 1988). I think it time we quit advising state legislatures on how to draft their tax statutes and confined ourselves to construing the statutes actually before us.

APPENDIX B

[Filed Nov. 6, 1996]

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 94-1418

PUBLIC SERVICE COMPANY OF COLORADO and
CHEYENNE LIGHT, FUEL AND POWER COMPANY,
Petitioners

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

OXY USA INC., *et al.*,
Intervenors

Consolidated with 91-1481, 94-1489, 95-1138

BEFORE: Williams, Ginsburg and Sentelle, Circuit Judges

ORDER

Upon consideration of the petitions for rehearing of Amoco Production Company, et al., and of respondent, it is

ORDERED that the petitions be denied.

Per Curiam

FOR THE COURT:
MARK J. LANGER
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

APPENDIX C

[Filed Nov. 6, 1996]

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 94-1418

PUBLIC SERVICE COMPANY OF COLORADO and
CHEYENNE LIGHT, FUEL AND POWER COMPANY,
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v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

OXY USA INC., *et al.*,
Intervenors

Consolidated with 94-1481, 94-1489, 95-1138

BEFORE: Edwards, Chief Judge; Wald, Silberman, Williams, Ginsburg, Sentelle, Henderson, Randolph, Rogers and Tatel, Circuit Judges

ORDER

Upon consideration of the Suggestions for Rehearing *In Banc* of Amoco Production Company, et al. and of respondent, and the absence of a request by any member of the court for a vote on either, it is

ORDERED that the suggestions be denied.

Per Curiam

FOR THE COURT:
MARK J. LANGER
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

Circuit Judges Henderson and Tatel did not participate in this order.

APPENDIX D

[Filed Nov. 6, 1996]

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 94-1418

PUBLIC SERVICE COMPANY OF COLORADO and
CHEYENNE LIGHT, FUEL AND POWER COMPANY,
Petitioners

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

OXY USA INC., *et al.*,
Intervenors

Consolidated with 94-1481, 94-1489, 95-1138

BEFORE: Williams, Ginsburg and Sentelle, Circuit Judges

ORDER

Upon consideration of the petition for rehearing of petitioners Public Service Company of Colorado and Cheyenne Light, Fuel and Power filed September 16, 1996, it is

ORDERED that the petition be denied.

Per Curiam

FOR THE COURT:
MARK J. LANGER
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

APPENDIX E

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. GP83-11-002 and RI83-9-003

COLORADO INTERSTATE GAS COMPANY

(Issued December 1, 1993)

ORDER ON COURT REMAND

Before Commissioners: Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.

On June 28, 1988, the United States Court of Appeals for the District of Columbia in *Colorado Interstate Natural Gas Co. v. FERC*, 850 F.2d 769 (D.C. Cir. 1988) (*CIG*) remanded to the Commission its decision in *Sun Exploration and Production Co. and Northern Natural Gas Co. (Sun)*.[1] In *Sun*, the Commission held that the Kansas *ad valorem*[2] tax was similar to a severance tax, and thus qualified for reimbursement under section 110 (a)(1) of the Natural Gas Policy Act of 1978 (NGPA). The Commission now reverses its decision in *Sun*, concludes that the Kansas *ad valorem* tax does not qualify under section 110(a)(1) of the NGPA, and orders refunds consistent with this order, effective as of the date of the court's decision.

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[1] 36 FERC ¶ 61,093 (1986); *reh'g denied, Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987).

[2] See appendix.

Introduction

In 1974, in Opinion No. 699, the Commission set a uniform national rate under the Natural Gas Act for producer sales of gas; which could be increased to recover "State production, severance or similar taxes." [3] In Opinion No. 699-D, the FPC held that any State *ad valorem* tax that was "based on production factors" was a "similar tax" which could be added to the national rate.[4] In response to a specific request for a ruling on the eligibility of the Kansas *ad valorem,* tax the FPC held that the tax qualified because "the bulk of the Kansas *ad valorem* tax is based upon production factors." [5] The FPC went on to explain that other states' taxes also could similarly qualify because they were taxes "on the amount of production and the revenues therefrom." However, on March 1, 1976, the FPC held that the Texas *ad valorem* tax was not a production, severance, or similar tax.[6] The FPC explained

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[3] *Just and Reasonable National Rates for Sales of Natural Gas,* Opinion No. 699, 51 FPC 2212, 2301-2, *reh'g denied in relevant part,* 52 FPC 1604 (1974), *aff'd sub nom., Shell Oil Co. v. FPC,* 520 F.2d 1061 (5th Cir. 1975), *reh'g denied,* 525 F.2d 1261 (5th Cir.), *cert. denied sub nom. California Co. v. FPC,* 426 U.S. 941 (1976).

[4] *See generally,* Opinion No. 699-D, *Just and Reasonable National Rates for Sales of Natural Gas,* 52 FPC 915 (1974), and *Mobil Oil Corp.,* 55 FPC 917 (1976).

[5] On December 31, 1975, the Commission set a national rate for gas flowing in interstate commerce prior to January 1, 1973 and continued to permit reimbursement of "State . . . production, severance, or similar taxes." *Just and Reasonable National Rates for Sales of Natural Gas,* 54 FPC 3090, 3124 (1975), *reh. denied,* 56 FPC 303 (1976), *aff'd in relevant part sub nom. Tenneco Oil Co. v. FPC,* 571 F.2d 834 (5th Cir.), *cert. denied,* 439 U.S. 801 (1978). In updating national rates for the 1975-76 period, the Commission adhered to its standard for tax reimbursement. *National Rates for Jurisdiction Sales of Natural Gas,* 56 FPC 509, 591, *reh. denied in relevant part,* 56 FPC 3698, 2807 (1976), *aff'd sub nom., American Public Gas Ass'n v. FERC,* 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied,* 435 U.S. 907 (1978).

[6] *Mobil Oil Corp.,* 55 FPC 917 (1976) (*Mobil*).

that although annual and future production of gas was used to determine the value of the gas property being taxed, "the tax itself does not depend on production" but rather "depends on the value of the remaining recoverable reserves." [7] The FPC noted that under the Texas tax "a gas property which had no production at all during a tax period due to a temporary shut-down would still have value and would incur tax liability in the period on that basis." [8]

The NGPA, enacted effective December 1, 1978, set maximum lawful prices (MLP) for the first sale of certain categories of natural gas. Under NGPA section 110(a)(1), the first sale price could exceed the MLP to the extent necessary to recover "State severance taxes attributable to the production of such natural gas." [9] The NGPA defined "State severance tax," as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." [10] The Conference Report accompanying the NGPA stated that the term "State severance tax" is to be "construed broadly" and includes "any tax imposed upon mineral or natural resource production including an *ad valorem* tax on a gross receipts tax." [11]

On January 11, 1983, Sun Exploration and Production Company (Sun) petitioned the Commission to issue a declaratory order, retroactive to December 1, 1978, asserting that the Texas *ad valorem* tax is a reimbursable severance tax under section 110. Subsequently, on August 22, 1983, Northern Natural Gas Company (Northern) petitioned the Commission to rescind the holding in Opinion No. 699-D that the Kansas *ad valorem* tax is reim-

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[7] *Id.* at p. 918.

[8] *Id.* at p. 918.

[9] 15 U.S.C. § 3320(a).

[10] 15 U.S.C. § 3320(c).

[11] S. Rep. No. 95-1126, 95th Cong. 2d Sess. at p. 91.

bursable under section 110.[12] On July 23, 1986, the Commission issued the order in *Sun* dealing with both petitions and denying them both on the merits.[13] Although the Commission observed that both the Kansas and Texas taxes were defined by statute as property taxes levied upon the fair market value of remaining recoverable reserves at the time of the assessment, the Commission found that the two taxes differed in "the degree to which production factors are taken into account." The Commission found that the Kansas methodology differed from the Texas methodology insofar as "*actual* current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used to determine the Kansas tax." [14] The Commission found that the Texas methodology only uses actual production to establish the rate of production decline for projecting future production and estimating remaining reserves. Further, the Commission reasoned, Texas has long assessed both a severance tax and an *ad valorem* tax, indicating that Texas considered the taxes to be separate and distinct. The order also rejected the argument that the Texas tax should qualify because of the statement in the Conference Report accompanying the NGPA that the term "State severance tax" is to be construed broadly. The Commission stated that the tax still must be "upon . . . production." [15] Finally, the Commission rejected Northern's various arguments that the Kansas *ad valorem* tax is a property tax.

Northern and CIG filed requests for rehearing regarding the portion of the July 23, 1986 order addressing the

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[12] Numerous parties intervened, including Colorado Interstate Gas Co. (CIG), which supported Northern's petition.

[13] The court upheld the Commission's refusal to dismiss the petitions on grounds of *res judicata*. 850 F.2d at p. 772.

[14] 36 FERC ¶ 61,093, at p. 61,224 (emphasis in original).

[15] 36 FERC ¶ 61,093, at p. 61,224.

Kansas tax. No party filed for rehearing of the Commission's ruling on the Texas tax. On January 28, 1987, the Commission denied rehearing on the same grounds as stated in the July 23, 1986 order.[16] Northern and CIG then sought court review of the Commission's ruling that the Kansas tax qualified under NGPA section 110.

In reviewing the Commission's orders, the court rejected each of the Commission's arguments justifying its decision. The court noted that "a tax nominally on property may be functionally identical to a production tax." [17] However, the court held that to find a tax was similar to a production tax, it would not be sufficient to merely find, as the Commission did, that the "bulk of the Kansas tax is based upon production factors." Rather there had to be a systematic analysis of any tax "by reference to [a] cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." [18] In particular reference to the Kansas tax, the court noted that the Commission had not identified those features that it believes constitute the production "bulk," much less the features excluded from the bulk. The court explained that in Kansas the ultimate tax on equal production may vary nearly by a factor of ten "because production is capitalized by multiplying by a present worth factor." [19]

The court also was unpersuaded by the Commission's reasons for treating the Kansas and Texas taxes differently since it found that both statutes assessed the cash market value of remaining recoverable reserves. Accordingly, the

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[16] *Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987).

[17] 850 F.2d at p. 772.

[18] *Id.* at p. 773.

[19] *Id.* at p. 771. The Court noted that the present worth factors in Kansas incorporate several assumptions including: an assumed discount rate, expectations as to future price changes, assumptions about rates of decline in production, and the probable length of production.

court remanded the case to the Commission for an analysis "to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently." [20]

KCC Motion to Reaffirm

On January 31, 1989, KCC filed a motion requesting the Commission to reaffirm its 1987 *Sun* decision.[21] The KCC argues that in its practical operation, the Kansas *ad valorem* tax is similar to a severance or production tax and should qualify under section 110. Kansas asserts that although nothing in the public record reflects the precise source of the language adopted in section 110 of the NGPA, it is reasonable to assume that the Conference Committee accompanying the NGPA meant to adopt the policy of the FPC—permitting Kansas producers to collect the *ad valorem* tax. The KCC asserts that a tax is "similar" to a severance or production tax under section 110 of the NGPA if the tax varies with the amount of natural gas produced.

The KCC states that a property's fair market value varies directly with the amount of gas produced from wells on the property and all other things being equal, a well that produces more gas than a neighboring well in the same field will be appraised at a higher value than the other well. Since the tax in Kansas is proportional to production, the *Sun* decision, that the Kansas tax is similar to a production tax, should be affirmed. KCC argues that

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[20] *Id.* at p. 775. The court noted that with the gradual elimination of federal regulation of natural gas prices, any change by the Commission could be of limited relevance. Since the court's decision, as a result of the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. 101-50, 103 Stat. 158, as of January 1, 1993, there no longer is any price regulation of natural gas.

[21] Attached to the KCC motion was the affidavit of Mr. Timothy N. Hagemann, a Kansas certified County Appraiser, which described how the *ad valorem* tax operated in Kansas.

to deny reimbursement of the tax would operate as an economic disincentive to production of natural gas.

CIG's Answer

On March 1, 1989, CIG filed an answer to the KCC motion to reaffirm.[22] CIG argues that the Kansas *ad valorem* tax is not assessed primarily on the volume or value of current production and does not constitute a production, severance, or similar tax under section 110 of the NGPA. CIG asserts that the KCC's position—that a tax is similar to a severance or production tax if it varies with the amount of natural gas produced—is no more cogent than the arguments presented by the Commission and rejected by the court in *CIG*. CIG argues that, under section 110, Congress intended that only taxes and certain other specific costs which are directly related to the volume and value of gas currently produced would be reimbursable such as the other NGPA section 110 costs (i.e., gathering, compression, treating, *etc.*) which are volumetrically related to the gas produced and sold. CIG asserts that the Kansas *ad valorem* tax is not assessed on the value of the gas sold and produced in any particular year, but instead is assessed on the value of the gas remaining in the reservoir after each year's production is removed.

CIG further states that in defining severance taxes, Congress used the words of the FPC's Opinion No. 699, but added the phrase "imposed on the production of natural gas." (CIG pet. at p. 13). CIG argues that where a tax is not imposed on production, but instead on the leasehold property, like the Kansas *ad valorem* tax, Congress did not intend that such a tax would be reimbursable. CIG contends that although production plays a role in the assessment of the Kansas *ad valorem* tax, it is not a

[22] Northern filed an answer opposing KCC's motion for the reasons set forth by the court in *CIG*, and by CIG in its answer.

determinative role. To establish that production is not the determining factor in the tax, CIG points out that two wells in different fields producing equal amounts of natural gas can generate different amounts of tax because the *ad valorem* tax uses a Present Worth Factor[23] in calculating the tax assessment. CIG argues that the KCC has focused on the operation of the Kansas tax within a given field, which conceals the true nature of the tax. While at the "microscopic" field level the tax appears to be one based primarily on the value of production, when examined at the state-wide, "macroscopic" level, as the tax is assessed in the various Kansas producing fields, the full nature of the tax emerges. CIG asserts that when viewed from both perspectives, it is clear that the tax fails to resemble a production or severance tax.[24]

Other Pleadings

On August 5, 1993, Missouri Public Service Commission (Missouri), and Southern Union Gas Company (Southern)[25] moved to intervene out of time, and filed a joint motion for summary reversal of the Commission's

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[23] As described in the Hagemann affidavit, the Present Worth Factor is a complex mathematical function of time, anticipated price escalation, time value of money, discount rate, and a production decline rate.

[24] CIG states that the Commission should not act without a full record and suggests that the Commission establish procedures to develop such a record. On April 14, 1989 the KCC responded to CIG's Answer by arguing that the interpretation of section 110 and the inferences that may be drawn from the operation of the Kansas tax call for legal analysis and not a factual evidentiary hearing, and submitted additional affidavits confirming that the description of the tax in the Hagemann affidavit was correct. (KCC motion to Lodge at p. 2.).

[25] Each claimed that it was involved in current proceedings which are dependent on the outcome of this proceeding. The Commission finds that good cause has been demonstrated and grants intervention under Commission rule 214(d)(1), 18 C.F.R. § 385.214(d)(1) (1993).

determination that Kansas' tax was similar to a production tax. On August 20, 1993, four natural gas producers, who had previously filed in support of KCC's motion, filed an answer opposing the joint motion, and urged the Commission to reaffirm its prior rulings on the Kansas tax.

Discussion

A. *Qualification of the Kansas* Ad Valorem *Tax under Section 110*

Although there are various types of taxes that producers pay, such as real estate taxes, personal property taxes, sales taxes, income taxes, excise taxes, and so forth, section 110 of the NGPA only permits the reimbursement of "State severance taxes borne by the seller" in addition to the ceiling price. These allowed taxes, in turn, are defined by the NGPA as "any severance, production, or similar tax." Other taxes are costs of doing business that the producer was to recover by the collection of the ceiling price. As clarified further in the legislative history, "State severance tax" is a stautory term of art that "includes any tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax" and is to be "broadly construed."[26] Upon reconsideration of the *ad valorem* tax in light of the language of the NGPA, the court's decision, and the facts of this case, including the text and application of the Kansas statute, the Commission finds that the tax does not qualify under section 110(a)(1) of the NGPA. The Commission finds that, for reasons as argued by CIG and Missouri, and as clarified further below, the Kansas *ad valorem* tax is not similar to a severance tax and is, instead, a non-qualifying personal property tax.

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[26] H.R. Cong. Rep. No. 95-1752, 95th Cong. 2d Sess. 91 (1978), 1978 U.S. CODE Cong. and Ad. News 8983, 9007.

1. Standards for Analyzing the Kansas *Ad Valorem* Tax

The Commission in *Sun* applied the standard that the Kansas tax qualified under NGPA section 110 because "actual current or prior-years' production volumes or the revenues derived therefrom are a significant factor in the formula used in determining the tax."[27] This standard appears to be a refinement of Opinion No. 699-D's broader statement that, to be deemed similar to a severance tax, the "bulk of the tax" must be based on "production factors." On review of these standards, we find that they are too vague and subjective, and improperly permit property taxes on the present value of reserves and lease properties in the state to qualify. Past or current production volumes and revenues are indeed "production factors" but they are factors that are used in judging the present value of all estimated future production from a lease or well.[28] Since the resulting valuation is of the remaining reserves, a tax on that value is a property tax and cannot qualify for reimbursement under section 110. Further, it is not feasible to establish any precise standard for deciding whether production is significant enough in the calculation of the Kansas *ad valorem* tax to qualify its bulk as being similar to a severance tax. Accordingly, we will not attempt to apply those standards here and as directed by the court, will clarify the standard for analyzing whether the Kansas *ad valorem* tax qualifies under section 110.

At the outset, we believe that section 110's allowance for taxes "similar" to severance taxes was meant to reflect

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[27] 36 FERC ¶ 61,093, at p. 61,224.

[28] The fact that current producing rates may be one factor considered in valuing the fair market value of a gas producing property merely reflects the fact that potential purchasers of such a property will naturally value it greater if it is producing high volumes of gas. In such cases, the cashflow from the property is a known fact and the investors can expect to recover their investment more quickly than if daily production is low.

Congress' intent that the substance of the tax, and not its mere label, be dispositive of the issue. Thus, the fact that the subject Kansas tax is titled as an *ad valorem* tax is of no importance to the resolution of the issue here. However, by the same token, we believe that the substance of the tax must fit some common, historical definition of a severance tax. By Congress' own definition, such a tax must be "upon" gas production or the value thereof and not, for example, on personal property. It is the tax basis —current production or personal property—that dictates whether the Kansas *ad valorem* tax qualifies under section 110.

Accordingly, to be deemed "similar to" a severance tax, a tax must have the substantive characteristics of a severance tax, and not a property tax. There are two essential characteristics of a severance tax. First, a severance tax is a tax on the act of severing, i.e., removing, a commodity from the earth. A severance tax is on the volume or value of the commodity *removed*, as assessed at the time of removal. A property tax is on the value of assets *remaining* in or on the earth at the time of the assessment. Thus, as relevant here, a gas severance tax is on the volume or value of the gas the moment it is produced; a property tax on gas leases or wells is on the value of the gas remaining in the ground as well as on the value of wells and other production assets on the lease, at the time of the tax assessment.[29]

Second, a severance tax in its purest sense is a tax on *each* Mcf or MMBtu of gas production, or the value

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[29] The value of such production, in turn, is a direct function of the volumes produced and the price obtained for the gas, but may also reflect a netting out of the producer's cost of production, gathering or other factors. If there is no sale of the gas production, as in the case of gas used for gathering system fuel, or if the sale is at a location other than the wellhead, some states may require some sort of wellhead market value price be imputed to the gas for the purpose of the severance tax.

thereof, *at the time of production,* although the state may bill the tax on a monthly or annual basis or may use some form of averaging of the production over the tax period.[30] The key point is that each time a single unit of gas is produced (i.e., "severed from the earth"), and only at that time, a severance tax liability arises directly proportional to the price and/or volume of the gas produced. There is a discrete event that triggers the severance tax liability—the production of a unit of gas. And, once the unit of gas is produced and the severance tax is applied to it, that unit of gas is never again subject to the severance tax. On the other hand, a property tax on gas leases and wells can be on what an assessor estimates as the net present value of *all* expected *future* production from the lease or wells, and may reflect all future expected costs and prices, as well as future depreciation, salvage value of facilities and so forth and will be based, in part, on current and historical costs and production data. Further, and unlike a severance tax, a property tax is applied to a unit of gas reserves each year—year after year—until that unit of gas finally is produced and removed from the property being valued.

2. Application of Principles to the Kansas *Ad Valorem* Tax

Applying these common, historic principles to the Kansas *ad valorem* tax, we find that it is a tax on property,

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[30] Thus, a tax on average or total production or production revenue over a current tax period, such as a tax year, could qualify as a severance tax since it is a surrogate for assessing the tax on each Mcf or MMBtu produced, or the revenue therefrom, during that period. As the court in *CIG* noted:

> If a state sought to capitalize the annual production (or revenue) enjoyed by each producer by multiplying it by a single fixed figure, the tax would plainly be similar enough to a production tax to qualify under § 110. *CIG* at p. 779.

However, the Court specifically held that neither Texas nor Kansas does that. *Id.*

not on production, and, therefore, does not qualify for reimbursement under section 110.[31] On its face and as applied by the state appraisers,[32] the Kansas *ad valorem* tax statute establishes a tax on the present value of personal property. Past and current production is used to estimate future, total production capability of the lease or well which, in turn is used to assess the present value of the gas reserves at the time of the tax assessment. The present value of wells and other leasehold equipment is also included. Like any tax on the value of gas reserves, "production factors" are a significant part of the valuation process. But the thing being valued and taxed is not each Mcf or MMBtu of current production at the time of production; it is the present value of lease property, including the gas reserves remaining in the ground, that is being valued and taxed. Hence, each year—year after year—an Mcf of gas reserves in Kansas will continue to be valued and taxed under the Kansas *ad valorem* tax until that Mcf is eventually produced and sold. Only when that Mcf of gas is produced and sold, does the producer be-

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[31] In this regard, we find that Kansas' own section 79-4217, which is described as an excise tax on the "gross value" of gas "severed from the earth," fits exactly the definition of an eligible "State severance, production, or similar tax." The Kansas severance tax, Kansas Stat. Ann. 79-4217, provides, in pertinent part, as follows:

> Mineral severance tax; imposition of tax; rate; measurement of production; exemptions. (a) There is hereby imposed an excise tax upon the severance and production of coal, salt, oil or gas from the earth or water in this state for sale, transport, storage, profit or commercial use, subject to the following provisions of this section. * * * Such tax shall be applied equally to all portions of the gross value of each barrel of oil severed and subject to such tax and to the gross value of the gas severed and subject to such tax. The rate for such tax shall be 8 percent of the gross value of all oil or gas severed from the earth or water in this state and subject to the tax imposed under this act. * * *

[32] *See* appendix.

come subject to a tax that does qualify as a severance tax under section 110, i.e., section 79-4217 of the Kansas statute.

The affidavit submitted by CIG confirms that the Kansas *ad valorem* tax is primarily an asset or property tax, rather than a production or severance tax because it is based upon "the present worth of the anticipated reserves" [33] less the costs of operation. Thus, it is quite simply, a tax on the current net value of recoverable reserves. As CIG argues, what is being taxed "is not the value of current production, but instead, the value of the leasehold interest, recognizing that current production is a 'yardstick' by which the value of the leasehold is measured." [34] Also, contrary to the KCC, the fact that the Kansas *ad valorem* tax may be greatly reduced in the case of a shut-in well does not turn the tax into a severance tax. That would be a case of the tail wagging the dog. This one feature of the tax that applies in that narrow circumstance when there is no production is not indicative of how the body of the statute operates when there *is* production. When there *is* production, the tax is applied just like any other property tax. In any event, when there is no production, there still can be an *ad valorem* tax assessed on the well and other lease property. A true severance tax only applies when gas is produced.

We also concur with the court's analysis that the 1980 amendment supports the view that the Kansas *ad valorem* tax is a property tax. The amendment requires that current actual production from a new well cannot be the basis for the tax if future production rates from the well are expected to be lower. Furthermore, our decision here is not contradicted by the 1982 amendment (section 79-4219) of the Kansas statute. That section provides that taxpayers who are subject to *ad valorem* taxes get a credit to the Kansas severance tax (section 79-4217) in

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[33] Hagemann affidavit, p. 3.

[34] CIG Ans. at p. 25.

an amount equal to 1 percent of the gross value of gas severed and taxable under the severance tax. Because current production may be factored into the *ad valorem* tax valuation (albeit to better assess expected future production and, therefore, the value of the remaining reserves), and also is taxed under the severance tax provision, the credit simply reflects that a small portion of the *ad valorem* tax may be somewhat redundant with a small (1 percent) portion of the severance tax. The relative insignificance of the credit *vis-a-vis* the total *ad valorem* tax base and resulting tax liability makes it abundantly clear that the *ad valorem* tax ultimately found due on a property is not "upon" current production to any significant degree.

B. *Date of Application of the Ruling of this Case*

Since we have concluded that the Kansas *ad valorem* tax does not qualify as being similar to a state severance tax under NGPA section 110, we must also determine the effective date of our decision. The issue before us is whether and, if so, to what extent this ruling should be made retroactively effective. A finding that our ruling should have prospective effect would have no effect at all inasmuch, as effective January 1, 1993, the statutory ceiling prices on natural gas were removed. Further, the date of enactment of the NGPA, December 1, 1978, is the maximum limit of potential retroactivity here because we have found that the Kansas *ad valorem* tax does not qualify under section 110 of the NGPA and, hence, reimbursement of that tax in addition to the ceiling violates the Congressionally-set maximum lawful prices. As discussed below, we do not view our authority as limited by the relevant case law to a choice only between maximum retroactivity and prospective application. Accordingly, we believe that there are a number of other relevant dates that could be considered for purposes of refunds: for example, the date the applicants sought a declaratory order in the instant proceeding (August 22, 1983); the date of the Commission's order in *Sun* (July 23, 1986); or the date

of the *CIG* decision (June 28, 1988).[35] Upon review of the relevant court standards of administrative retroactivity, we conclude that our ruling should be applied retroactively to the date of the court's decision in *CIG*, June 28, 1988.

In its recent decision in *Williams Natural Gas Co. v. FERC*, Nos. 90-1545 and 91-1543, (September 21, 1993) (*Williams*), the United States Court of Appeals for the District of Columbia Circuit discussed the question of retroactive application of administrative agency rulings. The court explained that, although a precise statement of the factors to be considered has varied from case to case, it has typically applied the following factors initially set forth in *Retail, Wholesale & Dept. Store Union v. NLRB*:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.[36]

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[35] We do not consider the date of Opinion No. 699-D, October 1974, as a viable option, since that related to the NGA and this proceeding involves application of the statutory definition under the NGPA. Moreover no party has urged such a date.

[36] 466 F.2d 380, 390 (D.C. Cir. 1972) (*Retail Union*). In the past the Commission has applied the standards for judicial retroactivity set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (*Chevron v. Huson*). *See, e.g., Dorchester Gas Producing Company*, 36 FERC ¶ 61,049 (1986), *aff'd Dorchester Gas Producing Co. v. FERC*, 848 F.2d. 636 (5th Cir. 1988). In *District Lodge 64, Int'l Ass'n of Machinists & Aerospace Workers v. NLRB*, 949 F.2d 441 at p. 447 (D.C. Cir. 1991), the court noted that the *Retail Union* test concerning retroactive application of agency decisions appears

However, the court in *Williams* did not review each factor as so stated and, instead, stated that, in applying the various versions of the *Retail Union* test, there has emerged "[a] basic distinction . . . between (1) new applications of law, clarifications, and additions, and (2) substitution of new law for old law that was reasonably clear." [37] The court explained that in the latter context, which may give rise to questions of fairness, "it may be necessary to deny retroactive effect to a rule announced in an agency adjudication in order to protect the settled expectations of those who had relied on the preexisting rule." [38] In the former case, it held, retroactivity is "natural, normal, and necessary." [39] Thus, the court stated, "we have repeatedly held that retroactivity is appropriate when the agency's ruling represents 'a new policy in a new situation,' rather than being 'a departure from a clear prior policy.' " [40]

This case involves a bit of both situations. On the one hand, as the court admonished in *CIG*, the Commission in *Sun* had no clear standard of analyzing state taxes for purposes of qualification under section 110. Today we are announcing that the common, historical standards for distinguishing between severance taxes and property taxes are to be applied. That would suggest full retroactivity. On the other hand, our ruling today clearly reverses an earlier Commission ruling that the Kansas *ad valorem* tax qualifies under section 110. As noted previously, the FPC had held in 1974 that the Kansas *ad valorem* tax was a "severance or production tax merely bearing the title

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substantively indistinguishable from the standard set forth in *Chevron v. Huson. But see Harper v. Virginia Dept. of Taxation*, 61 U.S.L.W. 4664 (U.S. June 18, 1993).

[37] *Williams* slip op. at p. 19 (*citing Aliceville Hydro Assocs. v. FERC*, 800 F.2d 1147, 1152 (D.C. Cir. 1986).

[38] *Id.*

[39] *Id.* (*citing NLRB v. Bell Aerospace*, 416 U.S. 267, 294 (1974).

[40] *Id.*

ad valorem tax," and eligible for upward adjustment from the applicable national rate. Enactment of NGPA section 110 using the terminology of the FPC, and with the Conference Report stating that the provision concerning reimbursement of severance taxes should be "construed broadly," [41] would, as the court noted in *CIG*, lead producers as well as purchasers to assume that the "Commission's earlier classification of the two states' taxes [Kansas and Texas] would carry over to the new regime." [42] Moreover, the Conference Report went on to add that the term severance tax "includes any tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax." [43] That would suggest no retroactivity.

We think that the balance tips in favor of partial retroactivity. The "settled expectations of those who had relied on the preexisting rule" established by the Commission's several prior rulings on the Kansas *ad valorem* tax were changed by the *CIG* decision, not really our own decision today. Before that date, the parties could justifiably expect to recover Kansas *ad valorem* taxes in addition to NGPA ceiling rates with no expectation of a later refund obligation. After that date, given the clear signal by the court in its decision, the parties no longer would have been justified in relying on the Commission's earlier rulings with any assurance that they would not later be required to make refunds of *ad valorem* taxes and could have taken steps to protect themselves, such as establishing an escrow account for such tax reimbursements. Our decision today merely adopts the court's analysis of the issue and rules in a way, we think, fully expected of this Commission by the court. For these reasons, we believe the

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[41] H.R. Conf. Rep. No. 1752, 95th Cong. 2nd Sess. 91, reprinted in 1978 U.S. Code Cong. & Admin. News, pp. 8800, 9007.

[42] 850 F.2d at p. 772.

[43] *Id.*

date of the *CIG* decision most appropriately accommodates the *Williams* criteria, rather than either a fully retroactive application back to December 1, 1978, or a fully prospective application (with no effect whatsoever).

C. Refund Procedures

1. Procedures for Refunds by First Sellers

First Sellers who collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser, including interest in full within 180 days after the Commission's final order is issued. The refund period will commence when the Commission's order becomes final.

2. Procedures for the Flowthrough of Refunds by Pipelines.

Under the Natural Gas Act, the Commission has jurisdiction over the rates interstate pipelines charge their customers. We establish the following procedures for interstate pipelines to pass through any *ad valorem* tax refunds they receive from first sellers.

a. *Method of Flowthrough by Interstate Pipelines*

Due to the implementation of Order No. 636 [*FERC Statutes and Regulations* ¶ 30,939], interstate pipelines have terminated their PGA clauses, which included a mechanism to pass through any refunds they received. Since this mechanism was used to reduce a pipeline's unrecovered purchased gas costs balance which would normally have been recovered from its customers over the next twelve-month period, this mechanism usually did not result in the flowthrough of refunds to customers in the same relative proportions of the actual overcharges because of changes in purchased gas patterns.

Since the PGAs have been terminated, *ad valorem* tax refunds can no longer be flowed through the PGA clause. In place of the PGA clause, pipelines have implemented PGA close-out procedures. However, these close-out procedures may result in methodologies that are even more divergent from the proportionate sales ratios reflected in the PGAs. Therefore, to ensure that *ad valorem* tax refunds will be made to customers who overpaid the pipelines and to avoid the problems of allocating these refunds to a pipeline's current customers, the Commission will require interstate pipelines to make a lump-sum cash payment to the customers who were actually overcharged. We will require pipelines to make refunds to the customers actually overcharged within 30 days after receipt of refunds from the producers. If a pipeline does not make refunds within this 30-day period, the interest provisions in section 154.67(c) will be triggered and interest must be paid from the date the pipeline receives the refunds from the producers until the date the pipeline pays refunds to its customers.

The Commission believes that a pipeline should: (1) allocate the refunds between jurisdictional and non-jurisdictional customers; and (2) allocate the total refunds due to the jurisdictional customers who were actually overcharged based on the proportion of each customer's purchases during the refund period compared to the total jurisdictional sales during the refund period. Pipelines would then pay this refund to those customers in a lump-sum cash payment. In any event, pipelines are to process *ad valorem* tax refunds from other pipelines in the same manner as *ad valorem* tax refunds received from first sellers because this procedure will return such amounts to those customers actually overcharged.

Finally, the Commission notes that pipelines will not be required to be guarantors of refunds. However, the Commission urges interstate pipelines to actively pursue refunds owed by first sellers.

b. *Pipeline Refund Reports*

The Commission will require interstate pipelines to file refund reports showing the amounts they received from producers (with principal and interest shown separately) and any producers who still owe refunds. The report must be filed 75 days after the date refunds are paid.

The refund report must also describe the basis a pipeline used to apportion the refunds among its customers and be served on all of the pipeline's customers. These reports will enable the Commission to assure that the customers have received appropriate refunds.

The Commission orders:

(A) The Kansas *ad valorem* tax does not qualify as a production, severance or similar tax under section 110 of the NGPA.

(B) The Kansas Corporation Commission's motion to reaffirm is denied.

(C) The Kansas Corporation Commission's motion to lodge is granted.

(D) The Kansas *ad valorem* tax may not be added to the maximum lawful price under section 110 of the NGPA on or after June 28, 1988.

(E) Any first seller that collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser, including interest calculated in accordance with §§ 154.102(c) and (d) of the Commission's regulations, in full within 180 days after the Commission's final order is issued, and shall file a refund report with the purchaser's concurrence within 75 days thereafter.

(F) Interstate pipelines must follow the refund flow-through procedures set forth in the text above.

APPENDIX

The Kansas Ad Valorem Tax

The *ad valorem* tax at issue is part of the general Kansas property tax imposed by Articles 79-1 through 79-28, Kansas Statutes Annotated. The properties are assessed by local assessors and taxed by local taxing jurisdictions within Kansas. Section 79-329 of the Kansas Statute defines properties that are capable of producing oil or natural gas in paying quantities, together with all casting, tubing or material thereon, as "personal property" and, therefore, subject to Kansas *ad valorem* taxes. Section 79-330 provides that, in valuing such properties for the purpose of tax assessment,

> there shall, in addition to the value of all oil- or gas-well material in or upon the leasehold properties, be made such valuation of the oil or gas wells as would make a reasonable and fair value of the whole property.

Section 79-331(a) states that in determining the value of oil or gas leases or properties, the appraiser shall take into consideration:

> the age of the wells, the quality of the oil or gas being produced therefrom, the nearness of the wells to market, the cost of operation, the character, extent and permanency of the market, the probable life of the wells, the quantity of the oil or gas produced from the lease or property, the number of wells being operated, and such other facts as may be known by the appraiser to affect the value of the lease or property.

Section 79-331(b) establishes an exception to section 79-331(a) in the case of new wells. Pargraph (b) provides that if a new well commenced production on or after July 1 of the preceding year, the actual production during the remainder of that preceding year will be reduced to 60 percent of that actual volume and then an-

nualized. In *Sun*, the Commission explained that this latter provision was designed to correct for the unusually high production rates of new wells ("flush production") in estimating production in subsequent periods. 36 FERC ¶ 61,093, at p. 61,224. Section 79-501 requires that tangible personal property shall be appraised at its fair market value which section 79-a defines as "the amount in terms of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming the parties are acting without undue compulsion." Section 79-a goes on to list various factors that are to be considered in determining fair market value, in addition to sales, such as location, depreciation, cost of *inter alia*, by capitalization of net income.

In *CIG*, the court described how the Kansas *ad valorem* tax is calculated: [1]

> The market value of annual production is calculated by multiplying past production (averaged over a three- or five-year period where available) by the price actually paid the producer on January 1 of the assessment year. Kansas then capitalizes annual production (i.e., infers a present capital value from income expected to be received over the future) by multiplying it by a "present worth factor" or "PWF."
>
> As would any capitalization formula, the PWF incorporates an assumed discount rate and expectations as to future price changes. Because natural gas is an exhaustible resource, the PWF also builds in assumptions (or information) about rates of decline in production and the probable length of production; these naturally vary from property to property.
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> * * * *
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> The PWFs in Table B range from 3.915 (for a zero decline rate and an eight-year life) to .673 (for a

[1] 850 F.2d at p. 771.

> 50% decline rate and a five-year life). After annual production is multiplied by the PWF, the resulting figure is adjusted downwards for operating costs and upwards for the assumed value of equipment. Although production plays an important role in tax computation, the variation cause by other elements—included because of the state's interest of ascertaining capital value—may make the ultimate tax on equal production vary nearly by a factor of ten.

The court's description is consistent with the description of how the tax is determined in the affidavit of a Timothy N. Hagemann, a Kansas Certified County Appraiser, submitted with the Kansas Corporation Commission's (KCC) motion to Reaffirm. The affidavit states that:

> (1) The appraiser first determines the well's "total average gas production." For a property in a major proven gas field, the total average production is the numerical average of production for the previous five years or the adjusted volume, after consideration for overages, underages and anticipated curtailed volumes. If the property is located in a field that is not considered a major field, the total average production is the numerical average of the past year's production.[2] The amount of remaining recoverable reserves are not taken into consideration.
>
> (2) The appraiser then multiplies the absolute average production by the "net price received." The net price received is the price of gas of January 1, of the tax year.

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[2] According to the Hagemann affidavit, the appraiser may adjust actual production figures to account for abnormal events. Thus, if production had been curtailed and then suddenly was resumed, the appraiser would adjust his assessment upward to reflect the anticipated increase in production for the upcoming year. Conversely, if a well has been overproducing and has exceeded its allowable production, the assessment will be lowered to reflect the anticipated curtailment.

(3) Next, the appraiser multiplies the estimated gross income stream by the "present worth factor" or "present value factor." The present worth factor is the product of (1) the rate of decline of gas reserves, (2) the assumed rate of increase in the value of gas, and (3) the present value discount factor. Present worth factors are promulgated by the Department of Revenue for each major proven gas field and are identical for all properties within the field. For properties in other fields, the appraiser must calculate the reserve decline rate based on the prior two year's production.

* * * *

(4) Finally, the appraiser adjusts the gross reserve value by deducting an allowance (fixed by the Department of Revenue for each field) for the present value of future operating costs. The appraiser also adds a standard amount to reflect the value of equipment, if applicable.

The result of all these calculations is the total "appraised value of gas production." The applicable tax rate is applied to 30 percent of the total appraised value.

APPENDIX F

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. GP83-11-003 and RI83-9-004

COLORADO INTERSTATE GAS COMPANY

(Issued May 19, 1994)

ORDER DENYING REHEARING AND GRANTING CLARIFICATION

Before Commissioners: Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.

On December 1, 1993, the Commission issued its order [1] on remand from the decision in *Colorado Interstate Gas Co. v. FERC (CIG).*[2] The order reversed the Commission's prior ruling and held that the Kansas *ad valorem* tax was not similar to a severance or production tax, and thus did not qualify as an add-on to the first sale maximum lawful price under section 110 of the Natural Gas Policy Act of 1978 (NGPA).[3] The Commission stated that the new rule would be applicable to sales on or after the date of the *CIG* decision. Requests for rehearing and clarification were filed by a number of parties. For the reasons set forth below, and in the December 1, 1993 order, the Commission denies rehearing and grants clarification.

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[1] 65 FERC ¶ 61,292 (1993).

[2] 850 F.2d 769 (D.C. Cir. 1988).

[3] 15 U.S.C. § 3320(a).

Background

The NGPA, enacted effective December 1, 1978, set maximum lawful prices (MLP) for the first sale of certain categories of natural gas.[4] However, under NGPA section 110(a)(1), the first sale price may exceed the MLP to the extent necessary to recover "State severance taxes attributable to the production of such natural gas."[5] The NGPA defined "State severance tax," as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas."[6]

Prior to passage of the NGPA, the Federal Power Commission (FPC), the Commission's predecessor, had held that producers could increase the applicable just and reasonable rate to recover "State production, severance or similar taxes" and that any State *ad valorem* tax that was "based on production factors" was a "similar tax" which could be added to the national rate.[7] In response to specific requests, the FPC held, in 1976 rulings, that the Kansas *ad valorem* tax qualified because the bulk of the tax was based upon production factors, but the Texas *ad valorem* tax did not.[8]

In 1983 parties moved before the Commission to reverse these rulings. However, in 1986, in *Sun Exploration and*

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[4] The Natural Gas Wellhead Decontrol Act of 1989 eliminated the remaining natural gas first sale ceiling prices, effective January 1, 1993.

[5] 15 U.S.C. § 3320(a).

[6] 15 U.S.C. § 3320(c).

[7] *Just and Reasonable National Rates for Sales of Natural Gas*, Opinion No. 699m 51 FPC 2212, 2301-2, *reh. denied in relevant part*, 52 FPC 1604 (1974), *aff'd sub nom. California Co. v. FPC*, 426 U.S. 941 (1976).

[8] Opinion No. 699-D, *Just and Reasonable National Rational Rates for Sales of Natural Gas*, 52 FPC 915 (1974), and *Mobil Oil Corp.*, 55 FPC 917 (1976).

Production and *Northern Natural Gas Co.*,[9] the Commission adhered to its prior rulings. The Commission held that the Kansas tax qualified because it was based on production factors. Rehearing was requested as to the ruling on the Kansas tax, which the Commission denied, and review was then sought in court. Rehearing on the Texas tax was not sought.

In 1988, in *CIG*, the court stated that in order to find a tax was similar to a production tax it would not be sufficient to merely find, as the Commission did, that the "bulk of the Kansas tax is based upon production factors." Rather, there had to be a systematic analysis of any tax "by reference to [a] cogent theory of what makes a tax 'similar' to a production or severance tax under § 110." [10] In particular reference to the Kansas tax, the court noted that the Commission had not identified those features that it believes constitute the production "bulk," much less the features excluded from the bulk. The court was also unpersuaded by the Commission's reasons for treating the Kansas and Texas taxes differently, since it could find no substantive difference between the two statutes. Accordingly, the court remanded the case to the Commission for an analysis "to identify the features of the Kansas tax that point toward one classification or another, and to offer sensible distinctions between taxes that it chooses to treat differently." [11]

On remand, the Commission abandoned its prior standards, i.e., whether the bulk of the tax was based on production factors (the standard set forth in Opinion No. 699-D) or whether production is a "significant factor" in the tax formula, as stated in *Sun, supra.* In the December 1, 1993 order, the Commission stated that section

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[9] 36 FERC ¶ 61,093 (1986); *reh'g denied, Northern Natural Gas Co.*, 38 FERC ¶ 61,062 (1987) (*Sun*).

[10] 850 F.2d at p. 773.

[11] *Id.* at p. 775.

110 of the NGPA requires that the tax must be "upon" production and not, for example, on personal property. The Commission adopted the test that, to be deemed similar to a severance tax, a tax must have the substantive characteristics of a severance tax, and not a property tax, and described the characteristics. Applying the common, historical definition of a severance tax, the Commission stated that, first, a severance tax is a tax on the act of severing, i.e., removing a commodity from the earth. Consequently, the Commission clarified, a tax on property such as the remaining gas reserves, does not qualify. Second, the Commission stated, a severance tax in its purest sense is a tax on each Mcf or MMBtu of gas production, or the value thereof, at the time of production, although the state may bill the tax on a monthly or annual basis or may use some form of averaging of the production over the tax period. Applying these principles to the Kansas *ad valorem* tax, the Commission held it is a tax on property, not on current production, and, therefore, does not qualify for reimbursement under section 110.[12]

The Commission also held that since it was reversing the Commission's prior ruling on the Kansas tax, it was necessary to determine the applicable date of the new rule. The Commission found that until *CIG* there was the settled expectation that the Kansas tax qualified as a severance tax. Accordingly, the Commission held that the new rule would only apply to first sales after the date of *CIG*.

Requests for Rehearing

A number of producers filing jointly (Producers) assert that the Commission erred in reversing its prior holding.[13]

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[12] Since the Commission held that the Kansas tax did not qualify, the rulings on the Kansas and Texas taxes are now the same.

[13] The producers are Amoco Production Company, Anadarko Petroleum Corporation, Mobil Oil Corporation, and Union Pacific Resources Company (successor to Champlin Petroleum Company).

They assert that the Commission should have adopted the standard that a tax qualifies if it varies directly with production such that it is a variable cost of production. Under this standard, they contend that the Kansas tax functionally operates similarly to a severance tax, and that the Commission's prior ruling was consistent with the statutory purpose underlying NGPA section 110, while the remand ruling is not. However, if the Commission does not grant rehearing on the qualification issue, Producers urge the Commission to make the ruling prospective from the date of the remand order and, thus, of no effect. They assert that the Commission's remand is the decision that changes the status of the tax, not the *CIG* decision, and accordingly, as a matter of equity, the new rule should be prospective only.

On the other hand, a number of parties support the ruling that the Kansas tax did not qualify, but assert that the Commission erred in making the ruling applicable only to first sales after the date of *CIG*. They contend that the Commission should have chosen an earlier date. The earlier dates they propose, which the Commission rejected in the order, are either August 22, 1983, when this proceeding was initiated, or October 4, 1983, when notice of this proceeding was published in the *Federal Register*.[14]

CIG also requests the Commission to modify the refund provision in the order. It argues that since the *ad valorem* tax has been held to be a tax on property and not on sales, the cut off date for producer refunds should depend on when the producer received the tax bill, not when it made the first sale. Thus, CIG urges the Commission to require producers to refund reimbursement of any tax bill received by producers after the date of the *CIG* decision.

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[14] Public Service Company of Colorado and Cheyenne Light Fuel and Power Company request either date. Colorado Interstate Gas Company requests the October 4, 1983 date, and Northern Natural Gas Company adopts CIG's position. Since CIG's request is the most extensive, the arguments will be referred to as CIG's.

Discussion

A. *Qualification Under NGPA Section 110.*

Producers argue that the Commission's order on Remand does not satisfy the court's directive to devise a cogent theory, grounded in the statutory purpose, for identifying taxes that qualify for reimbursement under section 110. Instead, they assert, the Commission's order makes no reference whatsoever to section 110's purpose. That statutory purpose, they assert, is the prevention of a disincentive to production that would result from the nonrecovery of a cost that varies with production. Producers argue that the Commission's standard conflicts with the statutory purpose of section 110 and focuses instead on what Producers assert is semantics, namely, that the tax must be "on" production. Producers assert that the Commission failed to adhere to the Conference Committee Report's specification that the term "severance tax" should be construed broadly to include taxes that, while not imposed directly "on" production, nonetheless vary directly with the amount of production. Accordingly, Producers assert that the Commission should have adopted the standard that a tax qualifies as a severance tax if it varies directly with production such that it operates as a variable cost of production. Moreover, Producers contend that the Kansas *ad valorem* tax varies directly with the level of production and operates as a variable cost of gas production and, thus, given the purpose underlying the NGPA to promote production, qualifies under NGPA section 110.

We find no merit in the arguments urged by Producers. The majority of the arguments urged by Producers, including those that rely on the statutory background to section 110 and the purpose of the NGPA are similar to those the court found unpersuasive in *CIG,* as did the December 1, 1993 order. At the outset, we disagree that the December 1, 1993 order focussed on semantics. The order specifically relied on the express language of section 110 and the Conference Report that the tax must be "on" or "upon" pro-

duction and, therefore, cannot be on something else, such as personal property or income. Moreover, consistent with what we believe is the intent of Congress, the December 1, 1993 order relied on the express purpose of the Kansas *ad valorem* tax, i.e., to tax personal property in the form of gas reserves and well equipment, tubing, and so forth. As the court in *CIG* noted, under the Kansas tax, assessors are "to use actual production figures only to the extent that these figures are helpful in ascertaining a property's value." [15] Thus, the appraiser can choose to ignore, or at least not fully reflect, the actual production if it is not helpful in ascertaining the value of the reserves. As the December 1, 1993 order observed, that the calculation of the Kansas tax bears some relationship to production only reflects the fact that gas reserves, i.e., usually the most valuable of the personal property being taxed under the Kansas tax, are more valuable if they can be produced quickly. This reflects what the court noted in *CIG*, that "the capital value of any property is in essence the net present discounted value of its anticipated income stream." [16] The quicker the reserves are to be produced and sold, the greater the net present value of the reserves.

Producers do not actually attempt to contest the Commission's explanation of what are the commonly perceived historical characteristics of a severance tax. Rather, they contend that, in addition to such taxes, Congress meant section 110 also to include property taxes where the tax is, under Producers' definition, "significantly affected by an increase or decrease in the level of natural gas production." Producers assert that such a mixed property/production tax would qualify as a "similar tax" under Congress' direction to construe the term "severance tax" broadly. Producers' proposed definition of a severance tax suffers from the same vagueness that the court found in the

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[15] *Id.* at p. 773.

[16] *Id.* at p. 770.

Commission's previous standard for evaluating when a tax qualifies as "similar" to a "severance tax." Thus, for example, while a tax on the income of a producer might vary in a more-or-less direct manner with production (which is sold and which generates taxable income), such a tax is clearly not a severance tax and cannot qualify under section 110. Under Producers' proposed standard, an income tax would qualify. Further, Producer's proposed definition gives rise to the same subjective line-drawing problem that plagued the Commission's former rule of attempting to define how significant the effect of current production is on the tax calculation. The Commission correctly reasoned in the December 1, 1993 order that it is not feasible to establish a precise standard for determining how "significant" production must be for the tax to qualify and Producers have not contested that finding on rehearing. In that circumstance, it was reasonable for the Commission to use its expertise to adopt the common, historical definition of a severance tax (a definition that Producers also does not contest on rehearing) which does not involve such a subjective, virtually well-by-well analysis to ascertain exactly how much weight the state property appraiser gave to current production. If the tax meets that historical two-pronged definition, then it will qualify under section 110 without any subjective evaluation by the Commission of the relative importance of current production to the tax calculation.

Producers argue that to hold that the tax does not qualify would be a disincentive to added production because it would add to the marginal cost of production, and the NGPA was designed to encourage the development and production of natural gas, citing, *Public Service Commission v. Mid-Louisiana Gas Co.*[17] Accordingly, Producers argue that the Kansas tax should be defined to be a severance tax so that the producers would not have

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[17] 463 U.S. 319, 331-38 (1983).

had a disincentive to produce gas. The Commission recognizes that an important purpose of the NGPA was to encourage production of natural gas. However, Producers' argument would be true as to every marginal cost of producing and selling natural gas; but section 110 only allowed certain costs to be recovered in add-ons to the NGPA ceiling rates.[18] For example, production costs are not allowed as add-ons under section 110. Thus, Producers must establish that the tax is one of the enumerated costs covered by section 110, not merely the fact that the tax would increase costs.

Producers also argue that the Kansas *ad valorem* tax varies directly with production and, therefore, the tax should be found to qualify under section 110. They assert that, like a "typical severance tax," the Kansas *ad valorem* tax operates as a variable cost of production.[19] Producers' unspecific reference to "production" obscures the distinction between current, daily production (which we believe Congress understood to be the basis for a severance tax), and past production used to establish the value of the remaining gas reserves for purposes of a non-qualifying property tax. Under a "typical" severance tax, such as Kansas' own Mineral Severance Tax,[20] the tax will vary directly with *current* production on essentially a 1:1 basis.[21] We find that the Kansas *ad valorem* tax does not

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[18] The only tax cost allowance specified in section 110 is for "state severance taxes attributable to the production of such natural gas." 15 U.S.C. § 3320(a)(1). Other production-related cost add-ons allowed are set forth in section 110(a)(2), such as allowances to recover gathering or treating costs. 15 U.S.C. § 3320(a)(2).

[19] Producers Request for Rehearing at p. 14.

[20] Kansas Stat. Ann.79-4217.

[21] This requirement of a generally 1:1 ratio with actual current production is fully consistent with how section 110 is commonly implemented. Under that section, severance taxes are allowed to be collected from the purchaser as part of the price of the gas sold in a first sale. NGPA ceiling prices are volumetric rates where the

vary with current production in any way similar to a typical severance tax. For example, if current production increases by 50 percent, then the severance tax would generally be expected to increase by roughly the same 50 percent factor. However, as more fully explained in *CIG*, the "production" used in the Kansas tax is not the current production in that tax period, but a three or five year average of production from the property which is capitalized by a present worth factor (PWF) to arrive at the value of the remaining gas reserves. Since Kansas uses an average of several years' of past production along with the current years' production to help measure the value of the gas reserves, i.e., the gas property, the Kansas tax does not exhibit the type and degree of a direct relationship to current production exhibited by a "typical" severance tax. For example, even when there is no production from a property in a particular year, there still could be an *ad valorem* tax liability because of production in prior years. Thus, if property A had production of 300 in each of years 1 and 2, and no production in year 3, it would still have average production of 200 for *ad valorem* tax purposes in year 3. Moreover, if property B has production of 300 in year 1, no production in year 2, and 300 production in year 3, both properties A and B could have the same *ad valorem* tax in year 3 even though property A's production had decreased to zero in that year and property B's had increased to 300 in that

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dollar cost of the gas purchased varies on a 1:1 ratio with the current level of actual production. Thus, producers generally recover severance taxes by an add-on to volumetrically-charged NGPA wellhead ceiling rates, and, therefore, the cost to the purchaser and, eventually, to the ultimate gas consumers, will vary directly on a 1:1 ratio with actual, current production. A severance tax charged on each Mcf or MMBtu of production would facilitate that type of pricing. A lump-sum annual or semi-annual personal property tax, such as the Kansas *ad valorem* tax, would cause price aberrations and would be inconsistent with the NGPA method of billing on a volumetric basis.

year.[22] Accordingly, we find that the Kansas *ad valorem* tax has a too remote, ephemeral, and often inconsistent relationship to the level of, and changes in, current "production" to classify it as a severance tax.

We also find Producers' reliance on the Kansas *ad valorem* tax treatment of shut-in wells as unpersuasive. Producers note that in *CIG* the court referred to Kansas' treatment of shut-in wells as giving current production a greater role than would seem normal for a standard property tax. The court referred to the fact that a well capable of production but not producing is appraised at a flat $20 per foot of depth. A well shut-in for two years is valued at the salvage value of the equipment.[23] Producers ask: How can the Kansas tax be "on the current net value of recoverable reserves," as the Commission emphasizes, when that value is not taxed at all in the case of a shut-in well? Before responding, we note that Producer's question incorrectly implies that the Commission's ultimate position rests on finding that the Kansas *ad valorem* tax is only on the present value of reserves. The Commission has relied on the fact that the tax is on all personal property at the production site including well equipment, casing, tubing, and so forth. The December 1, 1993 order addressed the treatment of shut-in wells and found that treatment could not be indicative of how the tax operates when there is production. Indeed, the fact that the tax in a shut-in well situation clearly and exclusively is on the value of personal property (the well)

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[22] Producers also contend that, although other variables can cause the tax on two wells producing at the same rate to be different, the tax still varies directly with production from each well. For example, because the Kansas *ad valorem* tax is calculated using a PWF that may vary from field-to-field, the tax could be significantly different for two production properties located in different fields even if they had the same average production in the past. However, if the production from two wells is the same, a true severance tax will be the same for both wells. Producers' argument only highlights a crucial difference with a severance tax, not a similarity.

[23] *See* 850 F.2d at p. 773.

and, hence, would not qualify even under Producers' proposed definition,[24] is hardly a logical basis to conclude that the tax does qualify in the circumstance where there is production.

Moreover, the tax treatment of shut-in wells is not inconsistent with the Commission's position that "production" is only factored in to establish the value of reserves. As the court in *CIG* noted, "the capital value of any property is in essence the net present discounted value of its anticipated income stream." [25] If a well has been shut in and is not expected to produce in the near term, any reserves penetrated by the well do not have any present commercial value and may never have any value if the well cannot be returned to production for either physical or economic reasons. In that circumstance it is not unreasonable to expect the state to tax only the value of the well itself to reflect the current lack of value of any underlying reserves.[26] If the producer can return the well to production, then an income stream can be projected that can be discounted and used to value the reserves. As we have discussed above, when a productive well ceases producing in any year, or even for an entire year, an *ad valorem* tax liability could still be incurred because it is not based only on that year's production, which would be true for a severance tax. Rather, a tax is incurred solely because the property's former production reflects the production potential of the well in the future which aids in assessing the net present value of the remaining reserves.

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[24] Because the tax still applies even when the well is shut-in, it neither applies to production, nor operates as a variable cost of production in that circumstance.

[25] *Id.* at p. 770.

[26] Of course, the state legislature may simply have relied on equitable considerations in reducing the personal property tax basis after a long period of no income from the property. Again, that says nothing about the relationship of the tax to current production when the producer is producing and selling gas from a well.

The question that we have addressed on remand is whether the Kansas *ad valorem* tax is similar to a severance or production tax. The Commission's previous standard for making that determination, like Producers' virtually identical proposed standard, was ill-defined and not administrable. The Order on Remand has now provided a well-defined, fully-supported standard of what constitutes a tax similar to a production or severance tax. Since the Kansas *ad valorem* tax does not have these characteristics, the Commission properly concluded that the Kansas *ad valorem* tax does not qualify as a production or severance tax under NGPA section 110. Accordingly, rehearing is denied on this issue.

B. *The Applicable Date of the Ruling*

Retroactive application of the ruling that the Kansas *ad valorem* tax did not qualify under NGPA section 110 would result in Producers having collected amounts in excess of the MLP in the past. Thus, the issue arose as to what should be the effective date of the new ruling concerning Kansas' *ad valorem* tax. The order analyzed this issue pursuant to the standards set forth in the recent decision in *Williams Natural Gas Co. v. FERC*,[27] where the court stated that when there is the "substitution of new law for old law that was reasonably clear," a question of fairness is present. Thus, in that situation, retroactive application of the new ruling may not be appropriate "to protect the settled expectations of those who relied on the preexisting rule." [28] The Commission concluded that on balance, the date of the *CIG* decision should be the applicable date because that decision put all parties on notice that the Commission's prior ruling on the Kansas *ad valorem* tax might be changed. The order is now challenged by both sides. Producers urging that the order

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[27] 3 F.3d 1544 (D.C. Cir. 1993).

[28] *Id.* at p. 1554.

should be prospective only, while others urge a prior date, namely commencement of this proceeding in 1983.

Producers assert that the Commission should have made the order prospective because the *CIG* decision did not change the law, but only the Commission's recent order did. Producers contend that *CIG* did not reverse the Commission's prior ruling but merely remanded the matter to permit the Commission to more fully explain the different treatment of the Kansas and Texas taxes. Producers argue that even after *CIG* producers had no reason to suspect the Commission would change its view of the Kansas tax, and assumed that the Commission would reaffirm its prior position upon remand. Thus, the order falls under *Williams'* category of a "new law for old law that was reasonably clear," and that under those circumstances, a shift in policy that the new ruling represents should be given purely prospective effect.

Producers also contend that even if the Commission maintains that the ruling should be applicable back to *CIG*, nevertheless, the Commission has discretion as to what type of remedy is appropriate. In this case, because of producers' reliance on the prior ruling, and the benefits received by consumers as a result of the prior ruling in the form of higher production, the equities require waiving refunds for events prior to the date of the Commission's order.[20]

On the other hand, CIG contends that the date of *CIG* is not the appropriate date but rather it should be the beginning of this proceeding. CIG contends that when notice of the commencement of this proceeding was published in the *Federal Register* on October 4, 1983, all parties were on notice that the ruling on the Kansas *ad valorem* tax was being challenged and could be changed.

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[20] Making the ruling prospective, would, as noted in the order, eliminate any refunds because all remaining ceiling prices were eliminated effective January 1, 1993, by the Natural Gas Wellhead Decontrol Act of 1989.

Thus, from that date on there no longer could be any justification for relying on the prior ruling.[30] Furthermore, the prior ruling was under the Natural Gas Act, while this proceeding involves the NGPA. CIG also contends that ordering refunds back to 1983 will merely require the producers to repay money they were not entitled to under the statute. In fact, CIG notes, in other situations involving collection of prices in excess of the MLP, the Commission has consistently required repayment of the overcollections since otherwise the Commission would be establishing a higher MLP than the one Congress established. Ordering refunds back to 1983 will place the appropirate refund dollars in the hands of consumers who were overcharged.

The question of the retroactive application of a "new ruling" raises a difficult and complex question. Before addressing the arguments raised in the rehearing requests, the Commission believes it would be helpful to set forth certain considerations.

In *Sun*, the Commission held that the Kansas *ad valorem* tax was similar to a severance tax and thus qualified for the add-on under NGPA section 110. In reaching that conclusion, the Commission followed the FPC's reasoning that the Kansas tax was primarily based on production factors, and then explained why the Kansas tax qualified but the Texas *ad valorem* tax did not. In *CIG*, the court found that the Commission had not offered any "principle for determining what relation to production is enough to qualify under § 110", nor had the Commission supplied "a persuasive explanation for simultaneously denying severance tax treatment to Texas's seemingly indistinguishable tax."[31] Our action here re-

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[30] As noted above, PSC Colorado contended that the date of filing of the proceeding, August 22, 1983, could also be considered the appropriate date since the filing established the date when the prior ruling was challenged.

[31] 850 F.2d at p. 779.

versing our prior ruling adopts a test which inexorably follows from the court's discussion in *CIG*. Having reviewed the Commission's prior reasoning and finding that it cannot stand in the light of *CIG*, our action here represents, to some extent, a correction of our prior approach. In such a situation, it is the Commission's task to attempt to "put the parties in the position they would have been in had the error not been made." [32] That obviously entails some form of retroactive relief to the parties that were harmed by the Commission's prior ruling.

However, even where the Commission corrects legal error, it does not automatically follow that the Commisison must grant full retroactive relief. An element in our consideration in this case, is that the issue presented is one of remedy, where the Commission has a wide latitude of discretion.[33] In short, "refunds are discretionary, and the Commission will consider the equities of the case before ordering refunds," *Transcontinental*, 65 FERC at p. 61,920, and whether refunds will "conflict" with the "core purposes of a statute." *Concord*, 955 F.2d at p. 76.

The courts have recognized that there are often equitable considerations which support limiting the retroactive effect of a new ruling, particularly where the past action based upon an erroneous legal order may have benefitted the parties entitled to some form of relief. Thus, as in this case, where that error may have lead to increased production which benefitted consumers, full retroactivity may not be appropriate:

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[32] *CPUC v. FERC*, 988 F.2d 154, 162 (D.C. Cir. 1992), *citing Consumers' Counsel, State of Ohio v. FERC*, 826 F.2d 1136, 1139 (D.C. Cir. 1987), and *Tennessee Valley Municipal Gas Ass'n v. FPC*, 470 F.2d 466 (D.C. Cir. 1972).

[33] *Towns of Concord, Norwood, and Wellsley v. FERC*, 955 F.2d 67 (D.C. Cir. 1992 (*Concord*); *Belco Petroleum v. FERC*, 589 F.2d 680, 686 (D.C. Cir. 1978); *Transcontinental Gas Pipe Line Corp.*, 65 FERC ¶ 61,189 (1993) (*Transcontinental*); *Union Electric Co.*, 64 FERC ¶ 61,355 (1993).

> In matters of prospective and retroactive effect, there are large questions of equity and public interest-both for agencies and for courts. While full refund under an invalid order is a sound basic rule, it may be offset, at least in part, by the lack of a mechanism to restore the full status quo ante, *the fact that consumers may have had the benefit of some increase in supply that would not have been forthcoming* under § 7 procedures, albeit purchased at an excessive price, and the fact that some portion of the increased prices paid may be discerned as consistent with just and reasonable producer rates.[34]

Another factor in deciding remedial issues is the equitable consideration of reliance. This consideration, i.e., the extent of a party's reliance on an old rule and the unfairness that would be created by disrupting the parties' settled expectations through application of the new rule, is at the heart of the various tests used to determine whether a new rule will be applied retroactively. It embraces the reliance interests under the third and fourth factors applicable to agency proceedings established in *Retail, Wholesale & Dep't Store Union v. NLRB*, which are "the extent to which the party against whom the new rule is applied relied on the former rule," and "the degree of the burden which a retroactive order imposes on a party."[35] *Williams, supra,* represents, a vari-

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[34] *Consumer Federation of America v. FPC*, 515 F.2d 347, 359 (D.C. Cir. 1975) (emphasis supplied).

[35] 466 F.2d 380, 390 (D.C.Cir. 1972) (*Retail, Wholesale*). The other *Retail Wholesale* factors are "(1) whether the particular case is one of first impression; (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of the law; . . . and (5) the statutory interests in applying a new rule despite the reliance of a party on the old standard." *Id.* In *District Lodge 64 v. NLRB*, 949 F.2d 441, 447 (D.C. Cir. 1991), the court stated that the *Retail, Wholesale* tests are "substantively indistinguishable" from the *Chevron Oil Co. v. Huson*, 404 U.S. 94 (1971) (*Chevron*), standard then applied to determine the retroactivity of judicial decisions.

ant on the *Retail, Wholesale* test, wherein the court summarized how *Retail, Wholesale* had been applied in specific cases.

Given these factors, we believe that the issue is subject to the considerations articulated in *Williams,* and none of the parties requesting rehearing contends otherwise.[36] Rather, they assert that our order did not correctly apply *Williams.* We find that none of the arguments raised has merit, and that under the *Retail Wholesale* equitable considerations, the date of *CIG* is the most appropriate one for the effective date of our ruling.

Producers' contention that *CIG* is of no consequence because it did not reverse the prior ruling begs the question and is not an accurate characterization of *CIG.* That decision clearly placed in jeopardy the validity of the prior ruling. To say that after *CIG* a party could still rely on the prior ruling without exposing itself to the risk

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[36] Since this is the initial case applying the new ruling on the Kansas *ad valorem* tax, the question of retroactivity is a different question than that faced by the Supreme Court in *Harper v. Virginia Department of Taxation,* 509 U.S. ——, 125 L. Ed. 2d 74 (1993) (*Harper*), and *James B. Beam Distilling Co. v. Georgia,* 501 U.S. ——, 115 L. Ed. 2d 481 (1991) (*Beam*). There the Court confronted not the formulation of a remedy between litigants in a single case, which is the issue before the Commission, but the extent to which a rule established in one case should be given retrospective effect to different parties in other cases. Moreover, in *Beam,* the plurality opinion noted that the decision did not determine what the appropriate remedy should be in a particular case, and also included the *caveat* that "we do not speculate as to the bounds or propriety of pure prospectivity," 115 L. Ed. 2d at p. 493. In *Tennessee Gas Pipeline Co.,* 66 FERC ¶ 61,266, at p. 61,649 (1994), the Commission stated that since it was applying a new rule for the first time, *Beam* and *Harper* were not applicable. Here too, the Commission is applying the new rule to the litigants in the proceeding before it. Finally, *Beam* and *Harper* may be inapplicable since they involved judicial, rather than agency proceedings. *See, District Dodge 64 v. NLRB,* 949 F.2d 447 (D.C. Cir. 1991). We note that *Williams* was issued in September 1993 subsequent to *Harper,* and continued to cite to the *Retail, Wholesale* analysis.

of a subsequent contrary ruling would be to ignore the court's analysis in *CIG*. After *CIG* producers were able to take steps to protect themselves in the event of a reversal of the Commission's prior ruling, and the onus from failure to do so must fall upon them, rather than on the consumer. Moreover, we are not dealing with unsophisticated individuals, but parties subject to governmental regulation of their production who are presumed to be aware of developments in that area. Thus, to require refunds starting with *CIG* is fair, and producers have failed to show why the Commission should waive any refunds that may be due.

We also find unpersuasive the arguments urged to establish an earlier date than *CIG*. First, we believe that until *CIG* there was justifiable reliance on the prior rule. As noted in the order, starting in 1974, the Commission and its predecessor had found that Kansas' *ad valorem* tax was similar to a production or severance tax. Enactment of NGPA section 110 using the same terminology, as well as the sparse legislative history on that section,[37] supports the view that the prior characterization of the Kansas tax would carry over under the NGPA. Moreover, after enactment of the NGPA, the Commission found certain state taxes qualified under section 110 as a similar tax relying on the FPC's prior characterization of the Kansas tax.[38] The fact that a party had commenced a proceeding which challenged the prior ruling would not in and of itself be a basis on which to assert that reliance on the prior ruling was no longer justified. It is only when the court acted, and questioned the rationale of the Commission's prior

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[37] The Conference Report on the NGPA states that "the term State severance tax is intended to be construed broadly." H.R. Conf. Rep. No. 1752, 95th Cong. 2d sess. 91, *reprinted in* 1978 U.S. Code Cong. & Adm. News, 8800 at p. 9007.

[38] *Independent Oil & Gas Ass'n*, 7 FERC ¶ 61,094 (1979), and *Trio Petroleum Corp.*, 18 FERC ¶ 61,203 (1982).

ruling, that reliance on that ruling would no longer be justified.[39]

It should be remembered that what is at issue in this case is the reimbursement of a tax paid by producers. This was a legitimate cost, not within the control of the producer. The producer paid the tax, and the prior ruling permitted the producer to seek reimbursement from the buyer, if the contract between them permitted it. By allowing reimbursement of the tax, the prior ruling promoted one of the goals of the NGPA by, as the court noted in *CIG*, removing a disincentive to production[40] without vitiating the consumer protection goal of the NGPA. The producer did not actually receive more than the MLP from the sale of the gas, because any amount above the MLP was the tax paid to the state. The prior ruling did not permit an unlimited increase in the price to the buyer, but merely allowed the producer, where the contract permitted, to add the tax to the MLP. Allowing producers to shift the tax to the buyer is not inimical with the NGPA goal of limiting the price of "old" gas.

The Commission's position with respect to Btu refunds, cited by CIG, is not inconsistent with our action in this proceeding. In the Btu case, the Commission, in interpreting the NGPA, permitted first sellers to measure the Btu content of natural gas based on the condition of the gas as delivered (the "dry rule") rather than under the "wet" rule that had been used under the National Gas Act (NGA). This increased the amount that the purchaser would have to pay for the same amount of gas. The court vacated the Commission's regulation and required maximum lawful prices (MLP) under the NGPA to be

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[39] CIG also asserts that beginning in 1983 it notified various producers in Kansas that it was CIG's position that the Kansas tax did not qualify under section 110. This is not any different than commencing the proceeding, and for all the reasons stated, we find reliance was justified until *CIG*.

[40] *See CIG, supra*, at p. 771.

calculated by measuring the Btu content under the wet rule.[41] In essence, the court held that Congress intended the MLP to be calculated the same way under the NGPA as the price of gas was calculated under the NGA, which would be the same throughout the United States.

In the case before us, Congress permitted add-ons to the MLP under section 110(a). In that section Congress used a broad standard, namely a tax imposed on the production of natural gas, for determining what state taxes qualified for such treatment. Congress delegated to the Commission the task of determining which taxes met that standard. Thus, which state taxes qualify as add-ons is determined by the Commission on an individual basis. In the Order on Court Remand we are changing our rule as to the Kansas taxes that may be excluded in calculating the MLP for gas produced in Kansas. The issue is as of what date does our new rule apply. The Btu case did not present that issue because that involved the method of determining the MLP itself and the court ruled what Congress intended from the date of enactment of the NGPA. Thus, the Btu case did not involve a matter delegated to the Commission for decision on a case-by-case basis pursuant to certain broad standards, but rather a matter that Congress itself had decided in the NGPA. The fact that in the Btu case the Commission required refunds retroactive to enactment of the NGPA has no application to this case, because if the Commission had not ordered refunds "it would effectively be establishing a ceiling price higher than the maximum lawful price prescribed in the NGPA." [42] This is not true in this case.

Moreover, in this case, CIG takes issue with the decision to make the new rule effective from the date of the *CIG*

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[41] *Interstate Natural Gas Association of America v. FERC*, 716 F.2d 1 (D.C. Cir. 1983), *cert. denied*, 465 U.S. 1108 (1984).

[42] Order No. 399, *FERC Statutes and Regulations, Regulation Preambles 1982-1985* ¶ 30,597, at p. 31,145.

decision, and argues that the commencement of this proceeding before the Commission should be the starting date because after that time "the parties no longer had "reasonable expectation that recoverability of those of those taxes would continue in light of the enactment of the NGPA." [43] The issue is thus one of notice and reliance. In this area the Commission has discretion to choose the appropriate date, provided there is a reasonable basis for that date. Just as we found that reliance on the prior ruling could no longer be justified after *CIG*, we also have articulated the grounds on which we choose the date of the *CIG* decision, and since there is a rationale basis for that choice, the Commission's decision must stand.

Having established *CIG* as the effective date of the new rule, collection of the Kansas *ad valorem* tax before that date was a valid add-on under NGPA section 110. Thus no refunds are due prior to *CIG*. However, even assuming *arguendo* that reimbursement of the amount in excess of the MLP as a result of the add-on of that tax was a violation, the Commission has the discretion to grant a waiver of the refund, if the equities require it. Thus even as to the Btu refunds the Commission stated it would waive the refund where the equities warranted it. There, as CIG cites in its rehearing request, the Commission first stated it could not relieve first sellers of the Btu refund obligation because to do so would sanction a price in excess of the NGPA ceiling price. First sellers argued that this was unfair because they did not retain all the funds, but paid over a portion to royalty owners, and in many instances they could not recover those payments. Upon rehearing, the Commission concluded that "it has the discretion to waive a portion of the first seller's refund

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[43] CIG Rehearing Request at pp. 7-8. CIG does make passing reference to enactment of the NGPA as the starting point, but does not press this date.

obligation, if it is demonstrated that the refund is uncollectible".[44]

3. CIG's Requests for Clarification

We find merit in CIG's request that we clarify what the *CIG* effective date means. CIG notes that the *ad valorem* tax is a tax on the assessed value of the property in January of the year of the year of taxation, but the tax bill is usually not received until November of that year.[45] CIG asserts that the tax is not on the producer's sales, so that the ruling should be applicable to reimbursement of the *ad valorem* portion of any tax bill received after the applicable date of the new ruling. Thus CIG argues the entire tax for 1988 would be covered by our ruling, assuming the tax bill was received after June 28, 1988. We find merit in this argument and will modify the refund provision in the order accordingly so that Ordering Paragraph (E) is modified to be applicable to any revenues collected in excess of the applicable maximum lawful price based upon any tax bill rendered after June 28, 1988.

CIG also requests the Commission to allow first sellers to make the refunds in the form of monthly payments over a two year period, with interest accruing on the outstanding balance, because the refund obligation may impose a hardship on some producers. The order allows first sellers 180 days within which to make the required

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[44] *Refunds Resulting from Btu Measurement Adjustment*, Order No. 399-A, *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,612, at p. 31,217 (1985). The Commission subsequently set forth what constituted uncollectibility, such as the royalty owner's being deceased or bankrupt or not locatable. *See, Wylee Production Corp.*, 33 FERC ¶ 61,014 (1985).

[45] CIG Requests for Rehearing at p. 5.

refunds. Since no first seller has requested any extension, the Commission will deny this clarification.[46]

The Commission orders:

(A) The requests for rehearing of the December 1, 1993 order are denied.

(B) The request for clarification is granted as provided in the order.

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[46] The Missouri Public Service Commission (Missouri PSC) requests the Commission to clarify the extent of the obligation of a pipeline to recover from producers the Kansas *ad valorem* tax and to refund it to customers from whom it was collected. In other proceedings Missouri PSC protested a pipeline's recovery from its customers the pipeline's payment of any amount in excess of the MLP that was based upon the Kansas *ad valorem* tax. The merits of those protests will be determined in those proceedings based upon the ruling we have made in this proceeding.

APPENDIX G

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. GP83-11-000

SUN EXPLORATION AND PRODUCTION COMPANY

Docket No. RI83-9-000

NORTHERN NATURAL GAS COMPANY

(Issued July 23, 1986)

ORDER DENYING PETITION FOR DECLARATORY ORDER THAT THE TEXAS AD VALOREM TAX IS A REIMBURSABLE TAX UNDER SECTION 110 OF THE NATURAL GAS POLICY ACT OF 1978, AND DENYING PETITION TO REOPEN, RECONSIDER, AND RESCIND OPINION NO. 699-D AS IT PERTAINS TO THE KANSAS AD VALOREM TAX *

Before Commissioners: Anthony G. Sousa, Acting Chairman; Charles G. Stalon, Charles A. Trabandt and C.M. Naeve.

On January 11, 1983, Sun Exploration and Production Company (Sun) petitioned the Federal Energy Regulatory Commission (Commission), pursuant to Rule 207 of the Commission's Rules of Practice and Procedure,[1] to issue

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* The issues in both dockets are related. Accordingly, we are issuing a single order.

[1] 18 C.F.R. § 385.207(a)(2) (1985).

a declaratory order, retroactive to December 1, 1978, stating that the Texas *ad valorem* tax [2] is a state severance tax within the meaning of section 110 of the Natural Gas Policy Act of 1978 (NGPA).[3] Notice of Sun's petition was published in the *Federal Register* on February 10, 1983 (48 Fed. Reg. 6164), and companies filed petitions to intervene.[4]

On August 22, 1983, Northern Natural Gas Company (Northern) petitioned the Commission to rescind Opinion No. 699-D [5] issued by the Federal Power Commission (FPC) (the Commission's predecessor) insofar as it pertained to the Kansas *ad valorem* tax. In that Opinion the FPC held that the Kansas *ad valorem* tax was a tax primarily based on production factors and thus producers could adjust upward the national rate established in Opinion No. 699 [6] by the amount of that tax. Northern asserted that, based upon Commission precedent, and subsequent Kansas legislative action, the Kansas *ad valorem* tax should be determined to be a property tax, rather than a "production, severance or similar tax," and that Northern was no longer obligated to reimburse Kansas sellers of gas for the *ad valorem* tax. Notice of Northern's petition was published in the *Federal Register* on October 4, 1983 (48 Fed. Reg. 45,287), and parties filed petitions to intervene both in support of and in opposition to the petition.[7]

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[2] Tex. Tax Code Ann. §§ 11.01 and 23.01 (Vernon 1982). In 1981 Texas repealed the existing tax articles and enacted the Texas Tax Code without any substantive change. Sections 11.01 and 23.01 are derived from Tex. Stat. Ann. art. 7145 and 7174 (Vernon 1960).

[3] 15 U.S.C. § 3320 (1982).

[4] *See* Appendix A.

[5] 52 FPC 915 (1974).

[6] 51 FPC 2212 (1974).

[7] *See* Appendix B. A number of parties question Northern's right to seek the relief asserting that the matter was fully adjudi-

Background

In Opinion No. 699, the FPC held that it would permit an upward adjustment in the national rate "for all State or Federal production, severance or similar taxes . . . ."[8] In Opinion No. 699-D, the FPC clarified that a state *ad valorem* tax (i.e., a property tax levied according to assessed value) which is based on production factors, will be considered a severance or production tax. The FPC accepted the argument that "the bulk of the Kansas *ad valorem* tax is based upon production factors," and accordingly it held that the Kansas tax was "a severance or production tax merely bearing the title *ad valorem* tax."[9] However, in *Mobil Oil Corp. (Mobil Oil)*, it held that the Texas *ad valorem* tax was not a "production, severance or similar tax," since "the tax itself does not depend on production [but] depends on the value of the remaining recoverable reserves."[10]

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cated and is *res judicata*. However, we find that the enactment of the NGPA and the subsequent Kansas legislative action are sufficient "changed circumstances" to warrant the Commission to entertain the petition.

[8] 51 FPC at 2301.

[9] 52 FPC 915 (1974). Kan. Stat. Ann. § 79-329 (1977) provides that "[F]or the purpose of valuation and taxation, all oil and gas leases and all oil and gas wells, producing or capable of producing oil or gas in paying quantities, are hereby declared to be personal property and shall be assessed and taxed as such." Kan. Stat. Ann. § 79-330 (1977) states that, in valuing oil and gas properties, there shall be made "such valuation of the oil and gas wells as would make a reasonable and fair value of the whole property." Finally, Kan. Stat. Ann. § 79-331 (1977) provides that:

> In determining the value of oil and gas wells or properties the assessor shall take into consideration the age of the wells, the quality of oil or gas being produced therefrom, the nearness of the wells to market, the cost of operation, the character, extent and permanency of the market, the probable life of the wells, the quantity of oil or gas produced from the wells, the number of wells being operated, and such other facts as may be known by the assessor to affect the value of the property.

[10] 55 FPC 917 (1976). The Opinion noted that "a gas property which had no production at all during a tax period due to a tem-

Section 110 of the NGPA codified the FPC's approach by permitting the seller to recover any "state severance tax" borne by the seller, in addition to the applicable maximum lawful price. NGPA section 110(c) and Commission regulation 18 C.F.R. § 271.1101(a)[11] both define a state severance tax as "any severance, production or similar tax, fee, or other levy imposed on the production of natural gas . . . ."

In 1979, after enactment of the NGPA, the Commission held that the West Virginia *ad valorem* tax fell within the meaning of "similar tax" because it was based on production factors. In reaching its conclusion the Commission referred to the fact that "gross income derived from gas production" was a factor used in the two valuation methods sanctioned in the West Virginia Code.[12]

Discussion

The two petitions which seek to change the treatment accorded *ad valorem* taxes in Texas and Kansas are related. Both ask that the Commission treat the Kansas and Texas *ad valorem* taxes in the same way.[13] However, Sun urges the Commission in effect to reverse *Mobil Oil* as it

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porary shut-down would still have value and would incur tax liability in the period on that basis." *Id.* at 918.

[11] 18 C.F.R. § 271.1101(a) (1985).

[12] *Independent Oil & Gas Association of West Virginia*, 7 FERC ¶ 61,094 (*IOGA*). The tax is provided for in W. Va. Code § 11-5-1 (1983). The two methods are capitalization of net income, and the multiplier gross income. In 1982, the Commission held that the West Virginia tax levied on producers of natural gas for gathering services under the Business and Occupation Tax, W. Va. Code §§ 11-13-1, *et seq.* (1983), fell within section 110 "since it has a basis in gas production." Trio Petroleum Corp. and Waco Oil & Gas Co., 18 FERC ¶ 61,203, at p. 61,412.

[13] Sun's petition also argues that the Texas tax is similar to West Virginia's, which in *IOGA*, *supra* note 12, the Commission held was eligible for reimbursement under NGPA Section 110.

pertains to Texas and hold that the Texas tax, like the Kansas tax, is a "similar tax," and that it is eligible for reimbursement. Northern argues that the Commission should follow *Mobil Oil,* rescind that part of Opinion No. 699-D dealing with the Kansas tax, and hold that the Kansas *ad valorem* tax is not a "similar tax," and like the Texas tax, is not eligible for reimbursement. We shall address this argument first, and then address the other arguments raised by Sun and Northern.[14]

The *ad valorem* taxes in Texas, Kansas, and West Virginia are all defined by statute as taxes on real or personal property and as such require an appraisal of the fair market value of the remaining gas reserves at the time of assessment each year. The difference, however, between the Texas tax and the taxes in Kansas and West Virginia is the degree to which production factors are taken into account in the methodology used to appraise gas properties for *ad valorem* tax purposes. The Texas tax is applied to the assessed cash market value of the remaining recoverable reserves (i.e., real property) in place and unsevered at the time of appraisal each year. The tax assessment is based on factors used to project the prospective *future* income (discounted to present value) that a prospective buyer could reasonably expect to derive from the production and sale of the remaining recoverable reserves in place at the time of appraisal on January 1 of each year. Actual current and prior year production data is used only to arrive at a declining rate of production to project future rates of production from the remaining recoverable reserves in place at the time of appraisal. On the other hand, while Kansas and West Virginia both utilize a present worth factor to evaluate gas properties (because an *ad valorem* tax is a tax on property) *actual* current or prior-years' production volumes or the revenues derived therefrom are a significant

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[14] None of the arguments raised by intervenors significantly differ from those urged by Sun and Northern in their petitions.

factor in the formula used to determine the tax. In addition, Texas has had both a severance tax [15] and an *ad valorem* tax for a long time, an indication that Texas looked upon the two taxes as separate and distinct taxes.[16] Accordingly, we find that there are valid reasons for treating the Kansas *ad valorem* tax as a tax "similar" to a severance tax, and the Texas tax as not similar to a severance tax.

Sun also contends that the legislative history of NGPA section 110 indicates that Congress intended the Commission to give an expanded interpretation to the term "state severance tax," thereby requiring a change in the FPC's conclusion in *Mobil Oil* that the Texas *ad valorem* tax was not similar to a severance tax. Sun cites the Conference Report which stated that "The term 'State severance tax' is intended to be construed broadly. It includes any tax imposed upon mineral or natural resource production including an ad valorem tax or a gross receipts tax." [17] This is not persuasive. The discussion in the Conference Report merely recognized that the FPC had permitted any tax that was based on production to be considered a severance tax, regardless of what it was labeled in the state tax code. But to fall within NGPA section 110 the *ad valorem* tax still must be one based "upon . . . production." Accordingly, we see no grounds for reversing *Mobil Oil,* and will deny Sun's petition.[18]

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[15] Tex. Tax Code Ann. § 201.051 (Vernon 1982), derived from Tex. Stat. Ann. art. 3.01 and 3.02 (Vernon 1960).

[16] Kansas enacted a severance tax in 1982 (Kan. Stat. Ann. § 79-4217 (1977)). However, the Kansas severance tax permits a 1% credit for *ad valorem* taxes paid on gas properties (Kan. Stat. Ann. § 79-4219 (1977)), showing that Kansas recognizes the *ad valorem* tax as one related to production.

[17] H.R. Conf. Rep. No. 1752, 95th Cong., 2d Sess. 91, *reprinted in* 1978 U.S. Code Cong. & Ad. News 9007.

[18] With reference to the FPC's statement in *Mobil Oil,* that in Texas shut-in properties still have value for *ad valorem* tax pur-

In support of its petition, Northern asserts that a 1980 amendment to the Kansas *ad valorem* tax[19] makes it more evident that the tax is a property tax and not an excise tax (an excise tax is one on the privilege of doing business, not owning property). Northern's argument, even if true, would make no difference, because it does not address the issue of whether the tax, however labeled, is one based on production. In fact, the amendment supports the FPC's conclusion that the Kansas *ad valorem* tax is based in substantial part on production. In *State ex. rel. Stephan v. Martin*,[20] the court explained that the amendment was adopted to address the problem resulting from the fact that a new well's initial production (known as "flush production") is ordinarily not an accurate indi-

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poses, Sun merely asserts that "in the usual case," shut-in properties are not assessed an *ad valorem* tax (Petition of Sun, p. 3), conceding that this is not required by statute. Moreover, the local assessor has the discretion of assessing a $10 an acre tax on non-producing gas properties.

[19] The amendment added the following two subsections to Kan. Stat. Ann. § 79-331 (1977):

> (b) The valuation of the working interest and royalty interest, except valuation of equipment, of any original base lease or property producing oil or gas for the first time in economic quantities on and after July 1 of the calendar year preceding the year in which such property is first assessed shall be determined for the year in which such property is first assessed by determining the quantity of oil or gas such property would have produced during the entire year preceding the year in which such property is first assessed upon the basis of the actual production in such year and by multiplying the income and expenses that would have been attributable to such property at such production level, excluding equipment valuation thereof, if it had actually produced said entire year preceding the year in which such property is first assessed by sixty percent (60%).
>
> (c) The provisions of subsection (b) of this section shall not apply in the case of any production from any direct offset well or any subsequent well on the same lease.

[20] 230 Kan. 747, 641 P.2d 1011 (1982).

cation of its production in subsequent periods. However, assessors had failed to take this fact into account in their *ad valorem* assessment, and often merely annualized the flush production. Such annualization led to "a greatly inflated production factor resulting in excessive valuation and assessment . . ." [21] The amendment was enacted to reduce this overassessment. It is thus clear, beyond question, that the Kansas *ad valorem* tax is based, in large part, on gas production.

Finally, Northern argues that the 1982 Kansas *ad valorem* tax it paid on certain wells, as a percentage of income from those wells, varied from well to well, which establishes "the fact that the Kansas *ad valorem* tax is assessed, not on production, but on remaining recoverable reserves." [22] Northern's argument is flawed because the Kansas *ad valorem* tax is not applied to the current tax year's "gross revenues," but to the "estimated gross income" (determined on January 1 of each tax year) based on *actual* prior years' production volumes. The ratio of *ad valorem* tax paid to estimated gross income for 1982, 1983 and 1984 varies only slightly for each of the wells cited by Northern. Thus we find no reason to change the FPC's conclusion that the Kansas *ad valorem* tax is based on production factors.

Neither of the petitioners has advanced arguments that persuade us that the prior decisions on the Kansas and Texas *ad valorem* taxes were erroneous. Nor have they shown that the assessment of these taxes has changed since the decisions were rendered in Opinion No. 699-D and in *Mobil Oil*, which would require a change in those decisions.

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[21] 641 P.2d at 1014.

[22] Petition of Northern, p. 4.

The Commission orders:

The petition for a declaratory order, filed in Docket No. GP83-11-000 by Sun Exploration and Production Company, that the Texas *ad valorem* tax is a tax based on production and is reimbursable under section 110 of the NGPA, and the petition filed by Northern Natural Gas Co. in Docket No. RI83-9-000 to reopen, reconsider and rescind Opinion No. 699-D as it pertains to the Kansas *ad valorem* tax, are denied.[23]

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[23] Since no one filed in opposition to the timely motions to intervene, they are automatically granted. 18 C.F.R. § 385.214(c)(1) (1985).

APPENDIX A

Docket No. GP83-11-000

Interventions

Producer-Sellers [1]*—Date of Filing*

1. Texas Oil & Gas Corp.—March 10, 1983

2. Mobil Producing Texas & New Mexico Inc.—March 11, 1983

3. Gulf Oil Corporation—March 21, 1983

Pipeline-Purchasers: [2]*—Date of Filing*

1. Northern Natural Gas Company, Division of Inter-North, Inc.[3]—February 18, 1983

2. Florida Gas Transmission Company—February 22, 1983

3. Colorado Interstate Gas Company—March 3, 1983

4. Lone Star Gas Company, a Division of ENSERCH Corporation [5]—March 7, 1983

5. Panhandle Eastern Pipe Line Company [6]—March 7, 1983

6. Trunkline Gas Company [3]—March 7, 1983

7. United Gas Pipe Line Company [3]—March 11, 1983

8. El Paso Natural Gas Company—March 14, 1983

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[1] Producer-sellers either support, or take no position with respect to Sun's petition.

[2] Pipeline-purchasers either oppose, or take no position with respect to Sun's petition.

9. United Texas Transmission Company [3]—March 14, 1983

10. Valero Transmission Company [3]—March 14, 1983

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[3] Purchasers filing motions to summarily deny Sun's petition pursuant to Commission Rules 212 and 217, 18 C.F.R. §§ 385.212 and 385.217 (1985).

APPENDIX B

Docket No. RI83-9-000

Interventions

(A) Petitions to intervene in opposition—Date of Filing

1. Arco Oil and Gas Company, Division of Atlantic Richfieled Company—October 17, 1983

2. Amoco Production Company—October 17, 1983

3. Chevron U.S.A. Inc.—October 18, 1983

4. Maurice L. Brown Company—October 19, 1983

5. Gulf Oil Corporation—October 19, 1983

6. Phillips Petroleum Company and Phillips Oil Company—October 19, 1983

7. Mobil Oil Corporation and Northern Natural Gas Producing Company—October 19, 1983

8. Aminoil Inc.—October 19, 1983

9. Champlin Petroleum Company—October 19, 1983

10. Mesa Petroleum Company—October 19, 1983

11. Pennzoil Company, Pennzoil Producing Company and Pennzoil Oil and Gas, Inc.—October 19, 1983

12. Ashland Exploration, Inc.—October 19, 1983

13. Texaco Inc.—October 20, 1983

14. Kerr-McGee Corporation—October 20, 1983

15. Getty Oil Company—October 20, 1983

16. Cities Service Oil and Gas Corporations—October 20, 1983

17. Shell Oil Company—October 20, 1983

18. Sun Exploration and Production Company—October 20, 1983

19. Kansas State Corporation Commission—October 20, 1983

20. Tenneco Oil Company—October 20, 1983

21. Dorchester Gas Producing Company—October 20, 1983

22. Cabot Petroleum Corporation—October 31, 1983

(B) Petitions to intervene in support—Date of Filing

1. Iowa Public Service Company—October 13, 1983

2. Iowa-Illinois Gas and Electric Company—October 14, 1983

3. Colorado Interstate Gas Company—October 14, 1983

4. Iowa Southern Utilities Company—October 17, 1983

5. Northwestern Public Service Company—October 17, 1983

6. Minnegasco, Inc.—October 17, 1983

7. Metropolitan Utilities District Of Omaha—October 19, 1983

8. Interstate Power Company—October 19, 1983

9. North Central Public Service Co.—October 19, 1983

10. Northern States Power Company (Minnesota), Northern States Power Company (Wisconsin), and Lake Superior District Power Company—October 19, 1983

11. Michigan Power Company—October 20, 1983

12. Minnesota Public Utilities Commission and Minnesota Department of Public Service—October 20, 1983

13. Wisconsin Gas Company—October 20, 1983

14. Iowa Power and Light Company—October 20, 1983

15. Minnesota Municipal Utilities Association and Northern Municipal Distributors Groups—October 20, 1983

16. El Paso Natural Gas Company—October 20, 1983

(C) Protests to deny Northern's petition—Date of Filing

1. R. W. Lange—October 20, 1983

2. Southland Royalty Company—October 24, 1983

3. Resource Tax Group—October 24, 1983

4. Tom F. Marsh, Inc.—October 24, 1983

5. Robert E. Campbell—October 27, 1983

6. Armstrong & Jackman—October 31, 1983

7. Oil Producers, Inc. of Kansas—November 3, 1983

(D) KN Energy, Inc., took no position in its petition to intervene filed on October 20, 1983.

APPENDIX H

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RI83-9-001

NORTHERN NATURAL GAS COMPANY

(Issued January 28, 1987)

ORDER DENYING REHEARING

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

On August 22, 1986, Northern Natural Gas Company (Northern) and Colorado Interstate Gas Company (CIG) filed requests for rehearing of that part of the Commission's order of July 23, 1986,[1] wherein the Commission reaffirmed that the Kansas *ad valorem* tax was a tax "similar" to a severance tax for purposes of section 110 of the Natural Gas Policy Act of 1978 (NGPA).[2] On September 23, 1986, we granted rehearing for the limited purpose of further consideration. For the reasons discussed below, the requests for rehearing are denied.

Background

In 1974 the Federal Power Commission (FPC), the Commission's predecessor, held that it would consider a state *ad valorem* tax (i.e., a property tax levied according to assessed value) which is based on production factors as similar to a severance or production tax, a ruling which

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[1] 37 FERC ¶ 61,093.

[2] 15 U.S.C. § 3320 (1982).

permitted producers to adjust upward the national rate prescribed for that gas by the amount of the tax paid.[3] In that opinion, the FPC also found that the "bulk of the Kansas *ad valorem* tax is based on production factors," and accordingly held that the Kansas tax was "a severance or production tax merely bearing the title *ad valorem* tax."[4]

Section 110 of the NGPA codified the FPC's approach by permitting the seller to recover any "state severance tax" borne by the seller, in addition to the applicable maximum lawful price. NGPA section 110(c) and § 271.1101(a) of the Commission's regulations both define a state severance tax as "any other levy imposed on the production of natural gas . . . ."[5] Further, the Conference Report explanation of NGPA section 110 states that "the term State severance tax is to be construed broadly. It includes any tax imposed upon mineral or natural resource production including an *ad valorem* tax or a gross receipts tax."[6]

The July 23, 1986 order found no reason to change the Commission's determination in Opinion No. 699-D concerning the Kansas *ad valorem* tax.[7]

Discussion

Northern and CIG argue that the July 23, 1986 order was erroneous because:

(1) The Commission ignored the plain language of the Kansas statute;

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[3] Opinion No. 699-D, 52 FPC 915 (1974).

[4] *Id.* at 915-16.

[5] 18 C.F.R. § 271.1101 (1986).

[6] H.R. Conf. Rep. No. 1752, 95th Cong., 2d Sess. at 91, *reprinted in* 1978 U.S. Code Cong. & Ad. News 9007.

[7] The order also adhered to the FPC's determination in *Mobil Oil Corp.*, 55 FPC 917 (1976), that the Texas *ad valorem* tax was not a "similar" tax, but was a property tax.

(2) The Commission ignored their *prima facie* showing that developments since the issuance of Opinion No. 699-D conclusively establish that the Kansas *ad valorem* tax operates as, and is administered as, a property tax and not one related to production;

(3) The order is internally inconsistent because it held that the Texas *ad valorem* tax, which is similar to the Kansas tax, was a property tax, not one based on production; and

(4) The Commission took no evidence and should have ordered an evidentiary hearing.

We find no merit in any of the contentions. Most, as Northern admits, are merely variations of arguments previously raised and rejected in the July 23, 1986 order.[8] An *ad valorem* tax, by its nature, is a tax on property. However, if such a tax is based on production factors, the Commission will consider it as a tax similar to a severance tax. The Kansas *ad valorem* statute has not been changed in any significant respect since Opinion No. 699-D was issued. In fact, as discusssed in the July 23 order, a 1980 amendment to the Kansas *ad valorem* statute buttresses the conclusion that that tax is based in substantial part on production factors. That amendment provides that for gas wells which start producing after July 1, a specific percentage of production is to be used, in the first assessment year. It was enacted because assessors annualized the initial production from a well which led to over-assessments, since initial production is often not an accurate indication of a well's true production capability.[9]

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[8] *See* Northern's Request for Rehearing, p. 2 n.3.

[9] *See* 36 FERC at p. 61,224. The order also specifically discussed the fact that in 1982 Kansas passed a severance tax. Passage of this tax did not change the character of the *ad valorem* tax.

We are satisfied that the Kansas *ad valorem* tax is one "based on production factors." [10] We see no need to hold an evidentiary hearing because this is a legal issue, which the Commission can decide on paper submissions.[11]

The Commission orders:

The requests for rehearing filed by Northern and CIG are denied.

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[10] We find no inconsistency in the fact that we reached a contrary conclusion on the Texas *ad valorem* statute because that statute uses a different methodology to appraise gas properties for *ad valorem* purposes.

[11] Additional submissions attached to the requests are not significantly different from material previously furnished and do not provide any basis to warrant reversal of our prior decision.

APPENDIX I

[Filed Dec. 6, 1996]

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 94-1418

PUBLIC SERVICE COMPANY OF COLORADO and
CHEYENNE LIGHT, FUEL AND POWER COMPANY,
Petitioners

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

OXY USA INC., *et al.*,
Intervenors

Consolidated with 91-1481, 94-1489, 95-1138

BEFORE: Williams, Ginsburg and Sentelle, Circuit Judges

ORDER

Upon consideration of the motion of Amoco Production Company, et al. for stay of mandate and of the opposition therto, it is

ORDERED that the motion is granted. The Clerk is directed to withhold issuance of the mandate through December 13, 1996.

Per Curiam

FOR THE COURT:
MARK J. LANGER
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

APPENDIX J

NATURAL GAS POLICY ACT OF 1978
15 U.S.C. § 3301, *et seq.*

* * * *

§ 3320. Treatment of State severance taxes and certain production-related costs

(a) Allowance for State severance taxes and certain production-related costs.—Except as provided in subsection (b) of this section, a price for the first sale of natural gas shall not be considered to exceed the maximum lawful price applicable to the first sale of such natural gas under this part if such first sale price exceeds the maximum lawful price to the extent necessary to recover.—

(1) State severance taxes attributable to the production of such natural gas and borne by the seller, but only to the extent the amount of such taxes does not exceed the limitation of subsection (b) of this section; and

(2) any costs of compressing, gathering, processing, treating, liquefying, or transporting such natural gas, or other similar costs, borne by the seller and allowed for, by rule or order, by the Commission.

(b) Limitation on State severance taxes.—The State severance tax allowable under subsection (a)(1) of this section with respect to the production of any natural gas may not include any amount of State severance taxes borne by the seller which results from a provision of State law enacted on or after December 1, 1977, unless such provision of law is equally applicable to natural gas produced in such State and delivered in interstate commerce and to natural gas produced in such State and not so delivered.

(c) Definition of State severance tax.—For purposes of this section, the term "State severance tax" means any

severance, production, or similar tax, fee, or other levy imposed on the production of natural gas—

(1) by any State or Indian tribe (as defined in section 3316(b)(2)(B)(ii) of this title); and

(2) by any political subdivision of a State if the authority to impose such tax, fee, or other levy is granted to such political subdivision under State law.

* * * *

§ 3411. General rulemaking authority

(a) In general.—Except where expressly provided otherwise, the Commission shall administer this chapter. The Commission, or any other Federal officer or agency in which any function under this chapter is vested or delegated, is authorized to perform any and all acts (including any appropriate enforcement activity), and to prescribe, issue, amend, and rescind such rules and orders as it may find necessary or appropriate to carry out its functions under this chapter.

(b) Authority to define terms.—Except where otherwise expressly provided, the Commission is authorized to define, by rule, accounting, technical, and trade terms used in this chapter. Any such definition shall be consistent with the definitions set forth in this chapter.

(c) Delegation of certain determinations.—The Commission may delegate to any State agency (with the consent of such agency) any of its functions with respect to sections 3315, 3316(b), and 3319(a)(1) and (3) of this title.

* * * *

§ 3413. Determinations for qualifying under certain categories of natural gas

(a) General rule.—

(1) Determination.—If any State or Federal agency makes any final determination which it is

authorized to make under subsection (c) of this section for purposes of—

(A) applying the definition of new natural gas under section 3312(c) of this title;

(B) deciding if certain natural gas produced from the Outer Continental Shelf qualifies under section 3312(d) of this title for the new natural gas ceiling price;

(C) applying the definition of new, onshore production well under section 3313(c) of this title;

(D) applying the definition of high-cost natural gas under section 317(c) of this title; or

(E) applying the definition of stripper well natural gas under section 3318(b) of this title;

such determination shall be applicable under this chapter for such purposes unless such determination is reversed under the provisions of subsection (b) of this section or unless such State or Federal agency has waived its authority under the provisions of subsection (c) of this section.

(2) Notice to Commission.—Any Federal or State agency making a determination under paragraph (1) shall provide timely notice in writing of such determination to the Commission. Such notice shall include such substantiation and be in such a manner as the Commission may, by rule, require.

* * * *

(e) Interim collection of maximum lawful price.—

(1) Collection of section 3319 price.—

(A) General rule.—Effective beginning on the first day of the first month beginning after November 9, 1978, a seller of natural gas which

is produced from a new well may, in accordance with subparagraph (B), charge and collect the appropriate maximum lawful price under section 3319 of this title for any first sale of such natural gas.

(B) Requirements.—A seller may charge and make collections under subparagraph (A) only in accordance with the following requirements:

(i) Sworn statement.—Before any such collection is made, the seller shall file with the Commission, and any Federal or State agency having authority to make determinations referred to in subsection (a)(1) of this section, a written sworn statement that such natural gas is produced from a new well and that such seller believes in good faith that such natural gas is eligible under this chapter to be sold at a price not less than the appropriate maximum lawful price under section 3319 of this title.

(ii) Petition for determination.—Within 90 days after November 9, 1978, the seller files a petition to such Federal or State agency for a determination under this section.

(iii) Collection subject to refund.—Any such collection made by the seller pending a determination under this section shall be collected subject to a condition of refund, with interest, in the event it is determined by such Federal or State agency that the applicable maximum lawful price is lower than that provided under section 3319 of this title.

(2) Alternate interim collection authority.—

(A) General rule.—Promptly after November 9, 1978, the Commission shall, by rule or order, provide one or more methods under which a seller of natural gas may, in accordance with requirements established, and for such period as may be prescribed, under such rule or order, charge and collect for any first sale of such natural gas the maximum lawful price under subchapter I of this chapter for which a petition is filed for a determination under this section in any case in which such price exceeds the appropriate maximum lawful price under section 3319 of this title.

(B) Collection subject to refund.—Any such collection made by the seller pending a determination under this section shall be collected subject to a condition of refund, with interest. Such refund with interest shall be paid, in accordance with the rule under subparagraph (A), unless it is determined under this chapter that the applicable maximum lawful price is equal to or greater than that collected. In addition, such seller shall comply with such requirements as the Commission shall prescribe in the applicable rule or order to provide adequate assurance that funds, to the extent attributable to a price in excess of the appropriate maximum lawful price under subchapter I of this chapter are available in the event of such refund.

(3) Collection after initial determination.—

(A) General rule.—Effective beginning on the date of the notice of a determination under subsection (a)(2) of this section, a seller of natural gas covered by such determination may,

in accordance with subparagraph (B), charge and collect the appropriate maximum lawful price applicable under such determination.

(B) Requirements.—A seller may charge and make collections under subparagraph (A) if such collection is subject to conditions prescribed by the Commission to assure refund, with interest, in the event it is determined under this chapter that the applicable maximum lawful price is lower than that provided under section 3319 of this title.

No. 96-954

Supreme Court, U.S.
FILED
APR 7 1997
CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

AMOCO PRODUCTION COMPANY, *et al.*,
Petitioners,
v.
PUBLIC SERVICE COMPANY OF COLORADO, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the court below correctly construed Section 110 of the Natural Gas Policy Act of 1978—which was repealed effective January 1, 1993—to require natural gas producers who (it is conceded) illegally collected certain amounts from consumers from 1978 through 1992 in violation of the Act to refund a portion of those amounts to consumers.

RULE 29.6 STATEMENT

Pursuant to S. Ct. Rule 29.6, respondent Public Service Company of Colorado notes that respondent Cheyenne Light, Fuel and Power Company is a wholly owned subsidiary. The following are nonwholly owned subsidiaries:

Natural Fuels Corporation
New Century Energies, Inc.
East Boulder Ditch Company
Hillcrest Ditch and Reservoir Company
United Water Company
Fisher Ditch Water Company
Baugh Lateral Ditch Company
Beeman Irrigating Ditch and Milling Company
Consolidated Extension Canal Company
Enterprise Ditch Company
Jones and Donnelly Ditch Company
Las Animas Consolidated Canal Company

Respondent Missouri Public Service Commission notes that it has no nonwholly owned subsidiaries or affiliates.

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IN THE

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OCTOBER TERM, 1996

No. 96-954

AMOCO PRODUCTION COMPANY, *et al.*,
Petitioners,

v.

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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF IN OPPOSITION

Respondents Public Service Company of Colorado, Cheyenne Light, Fuel and Power Company (collectively "PSCC"), and the Missouri Public Service Commission respectfully request that the Court deny the petition for certiorari filed by the private producers in this case.

INTRODUCTION

This Court's Rules specify that "certiorari will be granted only for compelling reasons." S. Ct. Rule 10. The decision below meets none of the criteria warranting such review. That unanimous decision—at long last bringing an end to litigation that began fourteen years ago—construes a narrow statutory provision that was enacted in 1978 and repealed in 1989, with the repeal completely

effective in 1993. There is no conflict among the circuits concerning this discrete provision, but even if there were the conflict would be of only historic interest, given the repeal. The cases on which petitioners rely in asserting the contrary construe *different* statutes involving markedly *different* regulatory regimes. The private companies seeking review assert that the decision below is important because it allegedly abridges the regulatory discretion of the Federal Energy Regulatory Commission ("FERC"), but the Solicitor General has elected not to seek review on FERC's behalf.

We doubt that the decision has the broader reach that the petitioners hypothesize; if it does, that fact should become apparent soon enough, when the court below applies the principles in this case to a statute of broader applicability that is actually still in effect. Review at this time, however, is clearly premature.

Nor is there any compelling case on the equities for disturbing the result below. As the case comes to this Court it is conceded that the producers collected the amounts in question from consumers illegally, *see* Pet. 5 n.3; all that the decision below requires is that they refund those illegally collected amounts to consumers. Indeed, the decision does not even require the producers to refund all amounts collected in violation of the Act, but allows them to retain amounts collected illegally from 1978 up to October 1983. The petition should be denied.

STATEMENT OF THE CASE

1. At issue is FERC's authority to permit natural gas producers to keep for themselves millions of dollars in reimbursements for Kansas *ad valorem* taxes, taxes which the court below held, and which the producers no longer dispute, were property taxes collected from customers from 1978 through 1992 in violation of the ceiling prices of Title I of the Natural Gas Policy Act of 1978

("NGPA"), 15 U.S.C. §§ 3311-33 (1988), *repealed*, Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, § 2(b), 103 Stat. 158 (1989). In 1974, the Federal Power Commission—FERC's predecessor—allowed the collection of certain states' *ad valorem* taxes pursuant to a rule promulgated under a different statute—the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717, *et seq.*—classifying *ad valorem* taxes based on production factors as severance rather than property taxes. Pet. App. 36a, 61a. Four years later, however, Congress replaced the NGA with "a substantially new regulatory regime"—the NGPA. *Id.* at 24a. The NGPA substituted statutory maximum price ceilings for the prices previously authorized under the NGA. *See* 15 U.S.C. §§ 3311-19. Section 110(a)(1) of the NGPA permitted producers to charge amounts in excess of those ceilings only to the extent they qualified as "state severance taxes" under the *new* regime, *id.* § 3320(a)(1), as defined in the NGPA itself. *See id.* § 3320(c).

2. In August 1983, an interstate pipeline petitioned the Commission to determine whether the Kansas *ad valorem* taxes were recoverable under Section 110(a)(1) of the NGPA. FERC published notice of that request in October 1983. Three years later, FERC ruled that the taxes were recoverable under Section 110(a)(1) as state severance taxes, *Sun Exploration & Prod. Co.*, 36 FERC (CCH) ¶ 61,093 (1986), but in 1988 the D.C. Circuit vacated FERC's decision. *Colorado Interstate Gas Co.* v. *FERC*, 850 F.2d 769 (D.C. Cir. 1988). On remand, the Commission ruled that the Kansas *ad valorem* taxes were in fact property taxes and thus not recoverable under Section 110(a)(1), and that prices charged by producers which included these amounts therefore exceeded the statutory price ceilings to that extent. It then ordered the producers to refund all amounts unlawfully collected after June 1988—the date of the D.C. Circuit's *Colorado Interstate* decision—permitting the producers to

retain millions of dollars collected illegally from 1978 to 1988 in violation of the NGPA. Pet. App. 49a-53a.

3. The producers thereupon challenged the Commission's decision that the taxes in question were property taxes rather than severance taxes, and argued that, in any event, the Commission's ruling "worked a change in the law that should be applied prospectively only." *Id.* 2a. PSCC, supported by the Missouri Public Service Commission as an intervenor, "challenge[d] the Commission's authority to limit the retroactivity of the producers' liability for refunds" to 1988—ten years *after* the NGPA was passed. *Id.* The court below upheld that portion of the Commission's decision determining that the tax was a property tax (which petitioners no longer dispute, *see* Pet. 5 n.3), but overturned that portion of the Commission's decision holding that the producers were only required to refund the taxes unlawfully collected since June 1988. *Id.* at 18a-24a.

4. As to the second component of its decision, the court below held that the producers were required to refund to their customers all taxes unlawfully collected after October 1983—the date on which interested parties first received notice that the recoverability of the taxes under the new statute (the NGPA) had been placed at issue and, according to the court, the earliest date that had been advocated by any party in this case. In reaching that result, the court rejected arguments "that the Congress intended to grant the agency the discretion to allow so capricious a thing" as to permit the producers "to keep some unlawful overcharges without any justification at all." *Id.* at 24a.

5. The panel unanimously denied rehearing, and the full court denied rehearing en banc, with no member requesting a vote. Pet. App. 31a-33a.

REASONS FOR DENYING THE WRIT

1. The accuracy of the central supposition underlying the producers' petition—that the court below engaged in an independent, *de novo* review rather than reviewing the agency's decision for abuse of discretion—is not apparent from the opinion itself. Certainly the court nowhere asserts that it is undertaking such an independent analysis or eschewing abuse of discretion review; the fact that "[t]he D.C. Circuit never explained why it failed to apply the deferential standard of review" (Pet. 16) may be because no such explanation was called for because there was no such failure. Indeed, the court rejected FERC's suggestion that "the Congress intended to grant the agency the discretion to allow so capricious a thing" as to permit the producers to keep the unlawful overcharges under the circumstances of this case. Pet. App. 24a. Thus, even under abuse of discretion review, it is clear that the court below found the agency's position "capricious" and beyond any discretion Congress may have conferred.

The producers are accordingly quite wrong in asserting that FERC's decision would have been affirmed under an abuse of discretion standard (Pet. 14) or that the alleged application of *de novo* review was "outcome-determinative" (Pet. 17). The petitioners contend that FERC's ruling "surely" would have been upheld under abuse of discretion review, because FERC necessarily had discretion to take into account the producers' "settled expectations" based on prior Commission rulings. *See* Pet. 9. The court below, however, ruled that any reliance by the producers on those rulings would have been "foolhardy," in light of the fact that the prior rulings were under the NGA while the NGPA was "a substantially new regulatory regime." Pet. App. 24a. Rewarding "foolhardy" reliance plainly would constitute an abuse of discretion, so the result below would be the same under abuse of discretion

or *de novo* review. Whether or not the producers' supposed reliance was foolhardy is of course a fact-bound issue not appropriate for this Court's review on certiorari.

Regardless of the standard of review, the court below simply determined that the agency lacked the authority under this particular statutory regime to permit the producers to do what the statute forbade—collect from consumers amounts in excess of the statutory ceiling prices.[1] *That* question has no broader applicability and indeed no future applicability at all, because the pertinent provisions of the statute in question were repealed effective January 1, 1993, and the regulatory regime of maximum ceiling prices has long since been replaced by a more market-oriented system. *See, e.g., District of Columbia* v. *Sweeney*, 310 U.S. 631 (1940) (petition for certiorari "denied in view of the fact that the tax is laid under a statute which has been repealed and the question is therefore not of public importance").

Certainly the decision below has not had the "important repercussions" predicted by petitioners (Pet. 17). In fact, in the more than seven months since the opinion was issued, it has *never* been cited by the D.C. Circuit, or, for that matter, any other court, federal or state.

2. Contrary to the producers' contention, the decision below did not precipitate a conflict among the circuits on

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[1] Certainly the producers are wrong in their unfair assertion that the court below "ignored the Commission's analysis" (Pet. 15). It did no such thing, as a reading of the opinion amply confirms. *See* Pet. App. 5a, 18a-19a, 21a-22a. The fact that the court did not ultimately affirm FERC's analysis does not mean that it "ignored" it.

The producers' current refrain that the court below should have deferred to the Commission is of course quite sharply at odds with their own position below, where they argued that the Commission erred and should be reversed for failing to make its decision wholly prospective. *See* Brief for Producer Petitioners, at 28-34; Reply Brief for Producer Petitioners, at 14-17.

the appropriate scope of judicial review of agency remedial orders. None of the five non-FERC cases cited by petitioners for the proposition that "review of agency remedial judgments must be deferential" (Pet. 9) remotely involves the question presented here: whether an agency has the "remedial" authority to permit those subject to its regulation to violate a statutory maximum price ceiling. Instead, each involved the quite different question of an agency's authority to impose sanctions within limits expressly defined by statute for a violation of the statute. Even in those situations the cases cited by petitioners recognize that an agency cannot impose a sanction "unwarranted in law," *Butz* v. *Glover Livestock Comm'n Co.*, 411 U.S. 182, 185-186 (1973) (quotation omitted), which is precisely what the D.C. Circuit determined would be the case if the producers were permitted to keep the amounts they illegally collected in excess of the statutory ceiling prices. Pet. App. 24a.

An agency's authority to fashion remedies in any given proceeding is drawn from—and governed by—the *statute* it is implementing. *Towns of Concord, Norwood, & Wellesley* v. *FERC*, 955 F.2d 67, 76 n.8 (D.C. Cir. 1992). Congress's narrow grant of remedial authority under the NGPA distinguishes this case from the others cited in the petition and eliminates any conceivable conflict with the cases relied upon by the producers, which involved entirely different statutory regimes.

Virtually all of the cases cited by the producers involve challenges to FERC actions under different statutory regimes—such as those established by the NGA and the Federal Power Act ("FPA")—in which Congress did indeed give to the Commission broad discretion both to fashion remedies and to order refunds as it saw fit. *See, e.g., Southern Natural Gas Co.* v. *FERC*, 813 F.2d 364 (11th Cir. 1987) (NGA); *Transcontinental Gas Pipe Line Corp.* v. *FERC*, 998 F.2d 1313 (5th Cir. 1993) (NGA); *Estate of French* v. *FERC*, 603 F.2d 1158 (5th

Cir. 1979) (NGA); *Gillring Oil Co.* v. *FERC*, 566 F.2d 1323 (5th Cir.) (NGA), *cert. denied*, 439 U.S. 823 (1978); *Gulf Oil Corp.* v. *FPC*, 563 F.2d 588 (3d Cir. 1977) (NGA), *cert. denied*, 434 U.S. 1062 (1978); *Borough of Ellwood City* v. *FERC*, 583 F.2d 642 (3d Cir. 1978) (FPA), *cert. denied*, 440 U.S. 946 (1979); *Boston Edison Co.* v. *FERC*, 856 F.2d 361 (1st Cir. 1988) (FPA); *Southwestern Publ. Serv. Co.* v. *FERC*, 842 F.2d 1204 (10th Cir. 1988) (FPA).

The NGPA established an altogether different regulatory regime. Under the NGPA, Congress specified maximum price ceilings (15 U.S.C. §§ 3311-33) and outlawed the collection of prices in excess of those ceilings. 15 U.S.C. §§ 3411-19. More to the point, unlike the situation with the NGA or the FPA, Congress in the NGPA did not give to the Commission the discretion to award refunds as it saw fit. Congress gave to the Commission the more limited task of determining when collected prices exceed the statutory limits, as well as the authority to bring civil and criminal proceedings to enforce the Act. *Id.* § 3414.

This critical distinction in regulatory regimes was not lost upon the court below:

> [T]he key point [made by PSCC] is that the Commission does not have the expansive remedial powers under the NGPA that it wielded under the NGA, 15 U.S.C. § 717c(e). Specifically, whereas the NGA gave the Commission discretion to order refunds if it determined that a rate was not just and reasonable, the NGPA established maximum lawful prices and gave the customer a right to a refund if it was overcharged. [Pet. App. 22a.]

3. The producers labor to obfuscate these important differences between the NGA and the NGPA by pointing to the NGPA's general administration provisions, authorizing the Commission to take action "as it may find necessary or appropriate to carry out its functions" under the

statute, 15 U.S.C. § 3411(a). Such general housekeeping provisions do not empower FERC to defeat the specific provisions of the NGPA by permitting producers to retain amounts collected in excess of the legislatively mandated maximum price ceilings. *See Maislin Ind., U.S., Inc.* v. *Primary Steel, Inc.*, 497 U.S. 116 (1990); *National Mining Ass'n* v. *United States Dept. of Interior*, 105 F.3d 691, 694 (D.C. Cir. 1997) ("general rulemaking provisions * * * do not * * * permit [agency] to trump Congress's specific statutory directive"); *American Petroleum Inst.* v. *EPA*, 52 F.3d 1113, 1119 (D.C. Cir. 1995) (agency "cannot rely on its general authority to make rules necessary to carry out its functions when a specific statutory directive defines the relevant functions * * * in a particular area").[2]

Indeed, FERC itself took the position—prior to this case, at least—that the NGPA "does not permit adjustment relief from the statute." *M.H. Marr*, 16 FERC (CCH) ¶ 61,118, at 61,272 (1981). Such a result, the Commission correctly recognized back then, would "impl[y] a power on the part of the Commission to selectively rescind by the exercise of adjustment authority whole sections of the NGPA." 16 FERC at 61,272-73. "This result," the Commission found, "could not have been

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[2] For this reason, the panel decision is fully consistent with *Laclede Gas Co.* v. *FERC*, 997 F.2d 936 (D.C. Cir. 1993). In that case, the court linked FERC's discretion in ordering refunds to 15 U.S.C. § 717o (authorizing FERC to take actions that are "necessary or appropriate to carry out the provisions" of the NGA). *See* 997 F.2d at 944. As noted, the NGPA has a similar provision, 15 U.S.C. § 3411(a), but that Act's regulatory scheme and core purposes are altogether *different* from the NGA's. Whatever the case under the NGA, no fair reading of the NGPA would support the conclusion that § 3411(a) authorizes the Commission to permit producers to keep millions of dollars in unlawfully collected amounts —in direct contravention to that Act's other provisions and its core purposes.

intended by Congress in enacting the NGPA." *Id.* It was not.[5]

4. The point is perhaps driven home by comparing the producers' petition for certiorari with their previous petition for rehearing and suggestion for rehearing en banc filed with the D.C. Circuit. The theme of the rehearing petition was that the decision below conflicted with numerous recent D.C. Circuit decisions deferring to FERC's exercise of remedial authority. *See* Pet. Reh. at 2, 7, 12 (citing, *e.g.*, *Public Utilities Comm'n* v. *FERC*, 988 F.2d 154 (D.C. Cir. 1993) (NGA); *Gulf Power Co.* v. *FERC*, 983 F.2d 1095, 1096 (D.C. Cir. 1993) (FPA); *Office of Consumers' Counsel* v. *FERC*, 783 F.2d 206, 233 (D.C. Cir. 1986) (NGA); *Columbia Gas Transmission Corp.* v. *FERC*, 750 F.2d 105, 109 (D.C. Cir. 1984) (FPA and NGA); *Arizona Elec. Power Coop.* v. *FERC*, 631 F.2d 802 (D.C. Cir. 1980) (FPA); *Niagara Mohawk Power Corp.* v. *FERC*, 379 F.2d 153, 155 (D.C. Cir. 1967) (FPA)). These decisions are not mentioned in the producers' petition for certiorari, of course, because they would at least raise a serious question whether the D.C. Circuit's decision in this case represents a dramatic but unannounced departure from these precedents, or instead is readily explainable for the reason we suggest—it, unlike the other cases, involves the NGPA, and its very different regulatory regime.

It is axiomatic that an agency's authority—including its remedial discretion—is limited to that delegated to it by Congress. The decision below is faithful to that funda-

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[5] Petitioners err in suggesting that the court was required to remand the case to the agency a *third* time. Pet. 14-15 & n.9. There is no requirement that a court "convert judicial review of agency action into a ping-pong game" when a remand would be unnecessary. *NLRB* v. *Wyman-Gordon Co.*, 394 U.S. 759, 766-767 n.6 (1969). *Accord American Train Dispatchers Ass'n* v. *ICC*, 26 F.3d 1157, 1163 (D.C. Cir. 1994) ("A remand is unnecessary where, as here, the outcome of a new administrative proceeding is preordained").

mental precept of administrative law. At the same time, it does not, as the producers assert, present any affront to other decisions recognizing FERC's broad discretion to fashion remedies under *different* regulatory schemes than the one at issue here. There is, accordingly, no conflict among the circuits.

For these reasons, the "Question Presented" by the producers quite clearly begs the question. The producers ask "[w]hether a court of appeals may review *de novo*—rather than for abuse of discretion—an administrative agency's exercise of the remedial authority delegated to it by Congress," Pet. i, when the whole point is that, as the court below ruled, Congress did not delegate remedial authority to FERC to authorize "producers to keep some unlawful overcharges without any justification at all." Pet. App. 24a. The producers do not even attempt to argue that *that* question—the narrow one that *is* presented in the context of a repealed statute by the decision below—warrants this Court's review. It does not.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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Nos. 96-954 and 96-1230

In the Supreme Court of the United States

OCTOBER TERM, 1996

AMOCO PRODUCTION COMPANY, ET AL., PETITIONERS

v.

PUBLIC SERVICE COMPANY OF COLORADO, ET AL.

WILLIAMS NATURAL GAS COMPANY, CROSS-PETITIONER

v.

AMOCO PRODUCTION COMPANY, ET AL.

ON PETITION AND CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether gas producers who charged prices in excess of the maximum lawful wholesale rate formerly in effect for natural gas under the Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.*, must make refunds that are retroactive either to 1983 or to 1978, the effective date of the Act.

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BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-30a)[1] is reported at 91 F. 3d 1478. The initial opinion of the Federal Energy Regulatory Commission (Pet. App. 35a-59a) is reported at 65 F.E.R.C. (CCH)

[1] References to "Pet. App." are to the appendix to the petition in No. 96-954.

¶ 61,292, and its opinion on rehearing (Pet. App. 60a-83a) is reported at 67 F.E.R.C. (CCH) ¶ 61,209.

JURISDICTION

The judgment of the court of appeals was entered on August 2, 1996. Petitions for rehearing were denied on November 6, 1996. Pet. App. 31a-34a. The petition for a writ of certiorari in No. 96-954 was filed on December 13, 1996. The cross-petition for a writ of certiorari in No. 96-1230 was filed on January 31, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This case concerns orders of the Federal Energy Regulatory Commission (Commission or FERC) requiring partial refunds of a Kansas *ad valorem* tax that natural gas producers had collected for more than a decade under an interpretation by FERC of Section 110 of the Natural Gas Policy Act of 1978, 15 U.S.C. 3320 (1988) (repealed), that was later reversed.

1. The Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*, authorized the Commission to establish "just and reasonable" rates for sales by the producers of natural gas. 15 U.S.C. 717d(a). In 1974, pursuant to that authority, FERC's predecessor, the Federal Power Commission (FPC), allowed producers to increase the otherwise applicable just and reasonable rate in order to recover "production, severance, or similar taxes."[2] Kansas imposed an *ad valorem* tax

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[2] Opinion No. 699, *Just and Reasonable National Rates for Sales of Natural Gas*, 51 F.P.C. 2212, 2301-2302, reh'g denied in relevant part, 52 F.P.C. 1604 (1974), aff'd *sub nom. Shell Oil Co.* v. *FPC*, 520 F.2d 1061 (5th Cir. 1975), cert. denied, 426 U.S. 941 (1976).

on producers that the FPC held qualified as a recoverable production tax.[3]

In 1978, Congress enacted the Natural Gas Policy Act (NGPA), 15 U.S.C. 3301 *et seq.*, which imposed certain statutory ceilings on natural gas rates. Section 110 of the NGPA allowed producers to recover charges in excess of the applicable statutory ceilings "to the extent necessary to recover * * * State severance taxes attributable to the production of" natural gas. 15 U.S.C. 3320(a)(1) (1988) (repealed) (Pet. App. 103a). Section 110 defined a severance tax for those purposes as "any severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." 15 U.S.C. 3320(c) (1988) (repealed) (Pet. App. 104a); see *id.* at 10a.

In 1983, after passage of the NGPA, several parties filed petitions with the Commission taking the position that the FPC's 1974 order should be abandoned and that recovery of the Kansas *ad valorem* tax should be disallowed under Section 110 of the NGPA. The Commission denied those petitions in *Sun Exploration & Production Co.*, 36 F.E.R.C. (CCH) ¶ 61,093 (Sept. 23, 1986), reh'g denied *sub nom. Northern Natural Gas Co.*, 38 F.E.R.C. (CCH) ¶ 61,062 (Jan. 28, 1987) (*Sun Exploration*), and authorized producers to charge prices in excess of the statutory price ceilings in order to recover the costs of the Kansas *ad valorem* tax.

2. The court of appeals granted a petition for review and remanded, concluding that the Commission had not explained its decision "by reference to any cogent theory of what makes a tax 'similar' to a

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[3] Opinion No. 699-D, *Just and Reasonable National Rates for Sales of Natural Gas*, 52 F.P.C. 915 (1974).

production or severance tax under § 110." *Colorado Interstate Gas Co.* v. *FERC*, 850 F.2d 769, 773 (D.C. Cir. 1988) (*Colorado Interstate*). Although the court acknowledged that the Kansas tax relates to production, in that "past production is used to estimate the net present value of future production from a gas-producing property, and thus the property's taxable value," the court held that the Commission "failed to offer any principle for determining what relation to production is enough for a tax to qualify under § 110." *Id.* at 770.

3. FERC concluded on remand that the Kansas tax should be viewed as a property tax and not a severance tax eligible for recovery under Section 110. Pet. App. 43a-49a. As a remedy, FERC ordered refunds of only those taxes that had been included in the rates charged after June 28, 1988—the date of the court of appeals' decision in *Colorado Interstate*. In FERC's view, before that decision, producers reasonably relied on Commission orders holding that the Kansas tax could lawfully be recovered. After *Colorado Interstate*, however, producers were on notice that the Kansas tax might no longer be recoverable under Section 110. *Id.* at 51a-53a.

Several parties petitioned FERC for rehearing, arguing for either non-retroactive or more fully retroactive refunds. Cross-petitioner Williams Natural Gas Company (Williams) (No. 96-1230) did not, however, seek rehearing. No party ever requested that FERC order refunds dating from 1978. The only party that even adverted to the possibility of refunds dating from 1978 was respondent Public Service Company of Colorado (PSCC). PSCC observed that "it could well be argued that the date of retroactivity should be established as far back as December 1, 1978,

the date on which the NGPA became effective," but conceded that "fundamental fairness . . . [dictates] that the date on which interested parties were put on notice of the dispute should control the date of retroactivity." Request for Rehearing, *Colorado Interstate Gas Co.*, FERC Dkt. Nos. GP83-11-003 and RI83-9-004 (Jan. 3, 1994) (PSCC Rehearing Request) at 6; see Pet. App. 19a. PSCC thus argued that FERC "should have selected August 22, 1983" (the date of the petitions urging the Commission to reverse its policy in view of enactment of the NGPA), "or in the alternative October 4, 1983" (the date when notice of those petitions appeared in the Federal Register), as the "operative date" for refunds. PSCC Rehearing Request at 6. FERC denied rehearing. Pet. App. 60a-83a.

4. The court of appeals granted a petition for review by utilities and state public service commissions affected by the scope of the remedial order,[4] and held the producers liable to refund all of the Kansas taxes collected for the period since October 1983. Pet. App. 18a-24a. The court relied on the same legal test as had FERC (see *id.* at 50a-51a), invoking "[t]he governing principle" that "when there is a 'substitution of new law for old law that was reasonably clear,' the new rule may justifiably be given prospectively-only effect in order to 'protect the settled expectations of those who had relied on the preexisting rule,'" *id.* at 18a (quoting *Williams Natural Gas Co.* v. *FERC*, 3 F.3d 1544, 1554 (D.C. Cir. 1993)).

The court, however, rejected FERC's selection of the date from which refunds should run under that

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[4] Cross-petitioner Williams participated in the appeal as an intervenor, pursuing only an issue not relevant here.

test, reasoning that "enactment of a substantially new regulatory regime [upon passage of the NGPA] in 1978 undermined any assurance that the FPC's treatment of the Kansas tax under the NGA would withstand scrutiny under the NGPA." Pet. App. 24a. The court emphasized that "[h]ere the agency did not change the law—rather, the Congress did when it enacted the NGPA in 1978." *Id.* at 28a. In the court's view, "the status of the Kansas tax was expressly drawn into question in 1983" when parties first petitioned FERC for a ruling that producers could not lawfully recover the tax under the NGPA. *Id.* at 24a. "Because no seller of natural gas could justifiably be confident that it was entitled to recover the tax until the legal question was settled anew under the new statute," the court held, "the producers' liability for refunds extends back to October 1983, the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under § 110 of the NGPA was at issue." *Ibid.*

The court did not require refunds for taxes collected from 1978 to 1983 because, it observed, "there is before us no controversy over those monies." Pet. App. 24a. Two litigants before the court of appeals, PSCC and the Missouri Public Service Commission (MPSC), raised the issue there for the first time, but the court rejected their claims. The court noted that PSCC had sought refunds only from 1983 before the Commission, that MPSC had not sought refunds and, in any event, as an intervenor on appeal, MPSC could "join issue only on a matter that has been brought before the court by another party." *Id.* at 20a n.* (quoting *Illinois Bell Tel. Co.* v. *FCC*, 911 F.2d 776, 786 (D.C. Cir. 1990)). Accordingly, the court con-

cluded, PSCC and MPSC were "precluded from raising that argument" before the court. Pet. App. 20a n.*.

ARGUMENT

We agree with petitioners Amoco Production Company, et al. (Amoco) (96-954 Pet. 8-14) that the remedial judgments of administrative agencies, including FERC, must ordinarily be accorded great deference, and may be set aside only for abuse of discretion or lack of substantial basis. We do not, however, view the court of appeals' decision as generally derogating from that established principle. The remedial question in this case arose in the specific context of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, which set statutory ceiling prices for natural gas, rather than affording FERC the discretion to do so, as under the NGA. Moreover, the operable provisions of the NGPA have since been repealed. Accordingly, review by his Court is not warranted.

1. Amoco contends (96-954 Pet. 9-11) that the decision of the court of appeals conflicts with cases recognizing the broad remedial discretion of administrative agencies, and affording deference to exercises of that discretion. The court below did not, however, purport to depart from those principles, or to call into question the District of Columbia Circuit's own decisions applying them. See, *e.g.*, *Exxel/Atmos, Inc.* v. *NLRB*, 28 F.3d 1243, 1246 (D.C. Cir. 1994) ("[W]e owe particular deference to the [agency's] choice of remedy."); *Laclede Gas Co.* v. *FERC*, 997 F.2d 936, 944 (D.C. Cir. 1993) ("FERC enjoys a great deal of flexibility in the remedy phase of an enforcement proceeding."); *Public Utils.*

Comm'n v. *FERC*, 988 F.2d 154, 163 (D.C. Cir. 1993) (citations omitted) ("[A]gency discretion is often at its zenith when the challenged action relates to the fashioning of remedies.") (internal quotation marks omitted); *Towns of Concord, Norwood, & Wellesley* v. *FERC*, 955 F.2d 67, 76 (D.C. Cir. 1992) (court "refuse[s] to constrain agency discretion by imposing a presumption in favor of refunds").[5] Thus, this case presents, at most, a misapplication of that principle in the particular context of this case. "[T]he misapplication of a properly stated rule of law" is rarely a basis for certiorari. Sup. Ct. R. 10.

Petitioners argue (96-954 Pet. 11) that "[t]here is nothing about this case to suggest" that a deferential standard of review of FERC remedies is inapplicable here. Section 501(a) of the NGPA broadly authorizes the Commission to "perform any and all acts * * * as it may find necessary or appropriate to carry out its functions" under the Act. 15 U.S.C. 3411(a). We agree that NGPA remedial provisions should be construed to confer broad discretion on FERC. See, *e.g.*, *Mustang Energy Corp.* v. *FERC*, 859 F.2d 1447, 1462 (10th Cir. 1988), cert. denied, 490 U.S. 1019 (1989). But there is some basis for the proposition that FERC's remedial discretion was uniquely constrained in this case. Indeed, the court of appeals specifically noted PSCC's argument that, "whereas the [Natural Gas Act] gave the Commission discretion to order refunds if it determined that a rate was not just and reasonable, the NGPA established

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[5] Indeed, the court's opinion cites with approval *Williams Natural Gas Co.* v. *FERC*, 3 F.3d 1544 (D.C. Cir. 1993) (see Pet. App. 18a)—one of the decisions that FERC itself invoked to support its remedial order.

maximum lawful prices and gave the customer a right to a refund if it was overcharged." Pet. App. 22a. And, the court further noted, "[h]ere the agency did not change the law—rather, the Congress did when it enacted the NGPA in 1978." *Id.* at 28a. It might therefore be argued that once rates were determined to exceed the NGPA's *statutory* ceiling, FERC lacked the full measure of authority that it has in the context of "just and reasonable" *administrative* rate-setting under the NGA to limit relief.

The Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, § 2(b), 103 Stat. 158 (effective Jan. 1, 1993), repealed the statutory price ceilings at issue in this case. Given that the court of appeals' decision arose in the context of the NGPA's statutory price ceilings—a feature that is absent from the NGA—the repeal of the operative NGPA provisions furnishes an additional reason for this Court to deny review.

Amoco's contention (96-954 Pet. 17-18) that the court of appeals' decision will interfere with FERC's administration of its regulations by undermining the reliability of Commission policy in the eyes of the regulated community appears to be unfounded. If the decision below is limited to cases arising under the NGPA, it should present no threat to the public's confidence in FERC's continuing regulatory programs under other statutory provisions. If regulatory compliance problems do arise, they might warrant review in a future case.

2. The claim of cross-petitioner Williams Natural Gas Company (Williams) (96-1230 Pet. 6-11) that FERC should have ordered refunds dating from 1978 was not raised by Williams in the court of appeals and thus is waived. See *Ryder* v. *United States*, 115 S. Ct. 2031, 2036 n.4 (1995). In any event, review is barred by

Section 506(a) of the NGPA, 15 U.S.C. 3416(a). Section 506(a)(2) states that "[n]o person may bring an action under this section to obtain judicial review of any order of the Commission unless * * * such person shall have made application to the Commission for rehearing under this subsection." 15 U.S.C. 3416(a)(2). Section 506(a)(2) also requires that "[a]ny application for rehearing shall set forth the specific ground upon which such application is based." *Ibid.* Section 506(a)(4) specifies that "[n]o objection to such order of the Commission shall be considered by the court if such objection was not urged before the Commission in the application for rehearing." 15 U.S.C. 3416(a)(4).

Cross-petitioner Williams failed to satisfy the requirements of Section 506. Cross-petitioner did not seek rehearing before the Commission. Section 506 requires that the party seeking judicial review must have raised the issue before the agency, and cannot rely on the fact that another party filed a petition. See *Williams Natural Gas Co.* v. *FERC*, 943 F.2d 1320, 1328 (D.C. Cir. 1991); *Railroad Comm'n* v. *FERC*, 874 F.2d 1338, 1342 (10th Cir.), cert. denied, 493 U.S. 954 (1989); *Interstate Natural Gas Ass'n* v. *FERC*, 716 F.2d 1, 15 (D.C. Cir. 1983), cert. denied, 465 U.S. 1108 (1984). In any event, as noted above, see pages 4-5, *supra*, no other party raised on rehearing the full-retroactivity issue petitioner now seeks to raise.[6] The statutory rehearing requirements are

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[6] Only PSCC filed a rehearing request that mentioned relief dating from 1978, but PSCC actually sought relief dating only from 1983. Thus, even had PSCC filed a certiorari petition in this Court seeking refunds back to 1978, it would not have met the Section 506(a)(2) "specific ground" requirement.

jurisdictional, and failure to meet them bars judicial review. See *Interstate Natural Gas Ass'n*, 716 F.2d at 15; see also, *e.g.*, *Escondido Mutual Water Co.* v. *La Jolla Band of Mission Indians*, 466 U.S. 765, 780 n.23 (1984) (citing parallel provision of Federal Power Act).

CONCLUSION

The petition and cross-petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOS. 96–954 & 96-1230

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

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Petitioners,
v.
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Respondents.

WILLIAMS NATURAL GAS COMPANY,
Cross-Petitioner,
v.
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AND
UNION PACIFIC RESOURCES COMPANY,
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On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF *AMICI CURIAE* STATE OF KANSAS and KANSAS CORPORATION COMMISSION IN SUPPORT OF PETITIONERS

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BRIEF OF *AMICI CURIAE* STATE OF KANSAS and KANSAS CORPORATION COMMISSION IN SUPPORT OF PETITIONERS

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Interstate Oil and Gas Compact Commission, *Produce or Plug: The Dilemma Over the Nation's Idle Oil & Gas Wells* (1997) 5

STATEMENT OF INTEREST OF *AMICI CURIAE*

Kansas ("Kansas") is a sovereign state. Its *ad valorem* tax gave rise to the proceedings[1] leading to this petition. Kansas' finances and industry are subject to disruption by the extreme retroactivity mandated by the United States Court of Appeals for the District of Columbia Circuit ("Court of Appeals" or "D.C. Circuit") decision at issue here. The Kansas Corporation Commission ("KCC") is the regulatory body charged with, among other duties, preventing the "production of natural gas ... in such manner ... as to constitute waste", and regulating "the taking of natural gas from any and all common sources of supply within this state in order to prevent the inequitable or unfair taking of natural gas from a common source of supply." Kan. Stat. Ann. § 55–701 & 703 (1996). Collectively, *amici* are referred to as "Kansas."

Kansas' interest in this case is twofold. On the first level, Kansas seeks reversal of a Court of Appeals decision which fails to take into account the practical realities of the Kansas gas industry and the impact its retroactivity order will have on this industry. It ignores the effect the decision will have on Kansas' ability to prevent waste of a finite natural resource and to finance its government in a rational way so as to properly serve its citizens.

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[1] *Public Service Co. of Colo.* v. *F.E.R.C.*, 91 F.3d 1478 (D.C. Cir. 1996). References to the opinion in this case are to the Petitioner's Appendix, "Pet. App. at _."

On the second level, Kansas is concerned with maintaining its proper role in the carefully crafted federal–state compromises, based on constitutional principles, set forth in the Natural Gas Policy Act of 1978 ("NGPA")[2], and approved in *Northwest Cent. Pipeline Corp.* v. *State Corp. Comm'n of Kansas*, 489 U.S. 493 (1989)("*Northwest Pipeline*"), that underlie this case. This balance is improperly altered by the standard of review used by the D.C. Circuit in reaching its decision. In view of these interests, Kansas is in a unique position to advise the Court as to the governance and constitutional issues raised by the D.C. Circuit's decision.

This brief is filed with the consent of the parties. Copies of the consent letters have been field with the Clerk.

STATEMENT OF THE CASE

This case arises from a 1996 decision[3] of the D.C. Circuit ordering refunds in a Federal Energy Regulatory Commission ("FERC") case[4] retroactive to 1983 rather than 1988. Kansas disagrees with the underlying decision overturning settled agency jurisprudence concerning the status of Kansas' *ad valorem* tax under Section 110 of the NGPA, but understands that issue is not before this Court.

The standard applied by the Court of Appeals to the underlying FERC decision presents an important issue of

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[2] 15 U.S.C. §§ 3301-3432 (1978).

[3] Note 1, *supra*.

[4] *Colorado Interstate Gas Co.*, 69 FERC ¶ 61,292 (1993).

administrative law which, to Kansas, has serious federalism implications. Petitioner frames the issue in terms of the standard of review to be applied in reviewing agency decisions under broad legislative grants of authority.[5] Cross–petitioner sees a case where a federal court has failed to carry out the directive of the legislative branch[6]. For the reasons set forth below, Kansas supports the Petition and opposes the Cross-Petition.

Kansas' position is that this case demonstrates the need for, and importance of, a uniform standard recognizing the preeminence of agency decisions based on statutorily granted remedial authority. The Court of Appeals' use of *de novo* review, instead of the accepted abuse of discretion standard, introduces a level of uncertainty and capriciousness into agency proceedings which directly and substantially impacts state governance. Kansas, as other sovereign states, must be able to rely upon final orders of the FERC in order to manage the state's natural resources and finances. As a matter of federalism, *de novo* review in these circumstances improperly intrudes on the balance between the states and the federal government captured in legislation such as the NGPA. These are issues at the core of the allocation of power in our federal system and, as applied, are critical to the day–to–day operations of the Republic.

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[5] Petition of Amoco Production Company., *et al.*, for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit, at 2 (hereinafter "Pet. at _").

[6] Cross–Petition of the Williams Natural Gas Company at 6.

REASONS FOR GRANTING THE WRIT

I. The D.C. Circuit's Decision Will Have A Severe Adverse Impact on Kansas.

The adverse impact of the D.C. Circuit's decision on Kansas' industry, conservation and fiscal policy is illustrated by review of the court's retroactivity order. The additional five years of refunds ordered by the appellate court is approximately $430 million (absent interest) above an equal amount of refunds for the years 1988 through 1993. *See* State of Kansas, Department of Revenue, Statistical Report of Property Assessment and Taxation, Table VIa (March 1996). Repayment will come not just from imagined large corporations with presumed larger cash reserves, of which there are few, but rather from hundreds of small producers and land owners, including royalty owners and working interest owners, across the state.

Gas and/or oil is produced in 89 of Kansas' 105 counties. The natural gas reserves in Kansas are the basis of a major state industry, employing approximately 24,000 Kansans. In the context of the national gas industry, in 1995, Kansas ranked 6th among the natural gas producing states (excluding the outer continental shelf which belongs to the federal government), 7th in severance and production taxes collected, and 6th in natural gas revenues with just under $1 billion collected. Hart's Oil and Gas World, Supp., *The Oil & Gas Producing Industry in Your State*, 1996-97 (Ind. Pet. Ass'n Am.), 100-07.

Of the 18,000 gas wells in the state, however, about 3000 are "stripper," or low volume wells[7], with low profit margins. The economic viability of many of these wells is threatened by the D.C. Circuit decision. *See* Kansas Corporation Commission, Internal Report, 2 (June 16, 1996). Kansas is in the process of estimating the number of these and other wells that may be abandoned prematurely due to the increased cost of operation stemming from the 10 years of refunds ordered by the Court of Appeals.

Abandoned or "idle" wells pose economic and conservation dilemmas for Kansas. If left unplugged or improperly plugged, waste results. Yet when plugged, a well is no longer capable of production with the result that the underlying resource is not available for use. In either case, the resources, and the revenue derived from the production of the gas, are lost to Kansas. Interstate Oil and Gas Compact Commission, *Produce or Plug: The Dilemma Over the Nation's Idle Oil and Gas Wells (1997)*.

Current taxes, including *ad valorem*, severance and conservation, represent about 14% of the sale price at the wellhead. State of Kansas, Department of Revenue Annual Report, 48 (1996). The refunds ordered by the Court of Appeals will increase the economic burden on natural gas production substantially, the amount per year depending upon the speed with which the refunds are recaptured. Resulting

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[7] Stripper wells are defined in the NGPA to be wells producing less than 60 Mcf per day. 15 U.S.C. § 3318 (1978). "Mcf" means 1,000 cubic feet of natural gas measured at a pressure of 14.73 pounds per square inch and a temperature of 60 degrees F. 15 U.S.C. § 3301(29) (1978).

abandonment of low margin gas wells will decrease the supply of gas, reduce tax revenues to Kansas and its local jurisdictions, raise potentially serious waste and conservation issues, and, to some unknown extent, reduce the pool from which repayment of the taxes may be sought.

II. The D.C. Circuit's Decision Applies the Incorrect Standard.

The Court of Appeals opinion begins by citing this Court's decision in *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Counsel, Inc.*, 467 U.S. 837 (1984), and agreeing that the standard of review is one of deference "to the administering agency's interpretation if it is reasonable in light of the structure and purpose of the statute. *Id.* at 842–43." Pet. App. at 6a. This is, however, the last mention of *Chevron* or its standard requiring deference to an administering agency's determination. Instead, the Court of Appeals ignores the standard of *Chevron* and proceeds with a *de novo* review of the underlying FERC decision demonstrating the need for this Court to establish a uniform standard of review of an agency's exercise of remedial authority entrusted to it by Congress.

A. The Correct Standard of Review is Based on Deference.

Petitioner ably demonstrates[3] that the standard of review applied throughout the courts of appeal in cases such as this, involving review of matters which Congress has delegated to an administrative agency for decision, is based on

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[3] Pet. at 8–14.

deference to that agency's determination. Petitioner's citations show (at 10–11) that regardless of the exact words used by the courts of appeal to define the standard, each decision contains the one factor the D.C. Circuit ignores, namely the principle that Congress entrusted oversight of the particular statute at issue to the agency, not the courts, in the first instance. The result of the D.C. Circuit's oversight, or perhaps judicial overreaching, is a standard of review that fails to give proper deference to the agency's decision. Under the D.C. Circuit's framework for analysis, the importance of the regulatory process is so reduced that no one can possibly "reasonably rely" on an agency's decision, even when the time for appeal has expired. Pet. App. at 24a.

B. The Court of Appeal's Decision Illustrates the Pitfalls of De Novo Review of Agency Decisions.

This Court has consistently deferred to regulatory agency administrative interpretations

> whenever [a] decision as to the meaning or reach of a statute has involved reconciling conflicting policies, and a full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations.

United States v. *Shimer*, 367 U.S. 374, 382 (1961). Even a cursory review of the NGPA reveals that the statute, and this case, are situations where "a full understanding of the force of

the statutory policy ... has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations." *Id.*

To reverse FERC's decision, the Court of Appeals had to engage in fact finding to support its legal conclusions. The underlying proceedings, however, did not lend themselves conveniently to facts supporting the D.C. Circuit's legal conclusions, so they are loosely inferred from FERC's opinion. For example, the D.C. Circuit places great weight on the fact that there was a lack of "detrimental reliance on the part of the producers,"[9] and concludes that

> [W]e are hard pressed to see how the producers would be harmed in any cognizable way even if they were required to disgorge every dollar they received in recovery of the tax (assuming any party were seeking such extensive relief).

Pet. App. at 23a.

Despite the Court of Appeals' rhetoric, there was "detrimental and substantial reliance" both on the Federal Power Commission's 1974 decision that Kansas' *ad valorem* tax qualified for recovery, and after enactment of the NGPA, on FERC's own reliance on the ante–NGPA Kansas *ad valorem* tax decision as a basis for other Section 110 recovery cases. *See Independent Oil & Gas Ass'n*, 7 FERC ¶ 61,094 at 61,143 (1979). In view of these agency rulings, settled at the time of

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[9] Pet. App. at 23a.

both the 1983 petition to FERC challenging recoverability of the Kansas tax and the Court of Appeals' 1988 remand decision,[10] the reliance considered so improper by the D.C. Circuit was also justified.

By stating that reliance on the FERC (and the early FPC) decisions was not reasonable, the Court of Appeals implies that Kansas purposefully turned a blind eye toward an issue having a potentially large impact not just on one of the major industries in its state, but also on the ability of Kansas and its political subdivisions to finance their operations through orderly tax revenues. Pet. App. at 24a. Kansas, however, will indeed be harmed by implementation of the Court of Appeals' decision. The disruption to this industry generating 24,000 jobs and almost $100 million per year in *ad valorem* tax revenue alone is a most serious matter. So is the fact that the impact of the retroactivity order will fall not just on large corporations, but also on many small landowners and rural counties without substantial alternative sources of revenue. In view of these fiscal, and related conservation and resource management concerns, Kansas is examining carefully how the additional $430 million, plus interest, will be assessed.

III. *De Novo* Review Violates Federalism Principles Contained in the NGPA.

As with most major pieces of legislation, the NGPA reflects the types of compromises among the states, and between the states and the federal government, made in Congress since the beginning of the Republic. *See Northwest*

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[10] *Colorado Interstate Gas Co. v. F.E.R.C.*, 850 F.2d 769 (D.C. Cir. 1988).

Pipeline, supra, 489 U.S. at 506–07 (discussing the Natural Gas Act). As a result of long negotiations, decisions were made concerning issues such as intrastate and interstate gas, reconciling the interests of producers, consumers, states with gas reserves and those without, factors to be included in the prices, and calculation of prices themselves.[11] Kansas, as a producer and consumer of natural gas, had varied interests in the bill.

The statute was entrusted to FERC to interpret and administer, taking into account the language of the statute, the legislative history of the Act, data, views and arguments, *etc.*, and balancing the competing interests in an equitable way with knowledge of all aspects of the issues. 15 U.S.C. §§ 3411-3418 (1978). The NGPA as passed by Congress, with the indicated structure of agency interpretation and administration, adequately protects Kansas' interests.

The standard of review applied by the D. C. Circuit, however, removes FERC from its Congressionally–established role as primary administrator of the NGPA and inserts an Article III decision–maker into a political process. This process, part legislative, part judicial and part equitable, illustrates why independent commissions such as FERC were established. They reflect, and are intended to reflect, the policy (and party) divisions and competing interests that shaped the legislation they administer. *See Northwest Pipeline, supra,* 489 U.S. at 510–12. A standard of review which removes the initial decision from such bodies, and absent a compelling constitutional reason,

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[11] The Clerk of the House is reported to have said that the House–Senate Conference resulting in the NGPA was one of the longest in the history of the Congress.

places it in the hands of individuals whose constitutional makeup and mission are markedly different, impermissibly alters the compromises made by Congress in agreeing to the legislation.

The result of the D.C. Circuit's judicial intrusion, therefore, can be analyzed under separation of powers principles. To Kansas, however, the lens through which the D.C. Circuit viewed this case -- in contrast to the one used by the other circuits -- results in the judicial branch altering a carefully crafted balance struck in Congress among the states' representatives, the administration of which was entrusted to FERC. While the distinction may be subtle, it is vitally important to Kansas that its constitutional role not be reduced through judicial overreaching.

As a practical matter, replacing FERC with an Article III decisionmaker also virtually ensures that this Court's statement in *Northwest Pipeline, supra,* 489 U.S. at 510, cannot be carried out:

> It has long been recognized that absent pre-emptive federal legislation or regulation, States may govern the production of natural resources from a common pool, in order to curb waste and protect the correlative rights of owners.

The Court's thorough analysis of states' and federal government's respective rights under the Natural Gas Act and the Natural Gas Policy Act in *Northwest Pipeline* showed that "pre-emption analysis must be applied sensitively in this area, so as to prevent the diminution of the role Congress reserved to

the States while at the same time preserving the federal role." *Id.* at 515. The role "reserved to the States" includes the ability to take "measures ... in furtherance of legitimate conservation goals." *Id.* at 513.

A decision such as the D.C. Circuit's here, one not taking into account this role because an improper standard of review was applied, will result in federal action that prevents Kansas from being able to take otherwise appropriate state action to preserve this natural resource, resulting in waste and loss of production and property. As this Court said in *Northwest Pipeline, supra,* 489 U.S. at 512, quoting, *FPC* v. *Panhandle Eastern Pipeline Co.*, 337 U.S. 498, 513–14 (1949), "we must be careful that we do not 'by an extravagant ... mode of interpretation push powers granted over transportation and rates so as to include production.'" The Court of Appeals has used just such an "extravagant ... mode of interpretation" with the predictable result.

Left as issued, the D.C. Circuit decision will have a chilling, and perhaps devastating, impact on the ability of Kansas to promote natural gas conservation and prevent waste of a valuable resource caused by the premature abandonment of natural gas reserves. This impact is particularly acute on the approximately 3,000 low production and margin stripper wells in Kansas. As the Interstate Oil and Gas Compact Commission noted in its 1996 report, *Marginal Oil and Gas: Fuel for Economic Growth*, stripper wells represent the ultimate in conservation because, once plugged and abandoned, access to the remaining gas is lost forever. However, abandonment or improper plugging of wells is a major source of waste. For this reason, Kansas, and most other oil and gas producing states,

encourages stripper well production and proper maintenance as a valuable means of conserving important natural resources.

IV. Conclusion.

The State of Kansas and the Kansas Corporation Commission respectfully request that the petition for a writ of certiorari be granted.

Respectfully submitted,

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Nos. 96-954 and 96-1230

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

AMOCO PRODUCTION COMPANY, *et al.*,
Petitioners,
v.
PUBLIC SERVICE COMPANY OF COLORADO, *et al.*,
Respondents.

WILLIAMS NATURAL GAS COMPANY,
Cross-Petitioner,
v.
AMOCO PRODUCTION COMPANY, ANADARKO PETROLEUM CORPORATION, MOBIL OIL CORPORATION, OXY USA, INC.
AND
UNION PACIFIC RESOURCES COMPANY,
Cross-Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF *AMICI CURIAE* THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AND THE KANSAS INDEPENDENT OIL AND GAS ASSOCIATION IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether a regulated entity is entitled to rely on a final agency decision unless and until that decision is overturned by the agency or a court of competent jurisdiction in a later case, or an act of Congress.

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BRIEF OF *AMICI CURIAE* THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AND THE KANSAS INDEPENDENT OIL AND GAS ASSOCIATION IN SUPPORT OF PETITIONERS

STATEMENT OF INTEREST OF *AMICI CURIAE*

The Independent Petroleum Association of America ("IPAA") is a national trade association representing approximately 5,500 individuals and independent oil and natural gas producing companies involved in the exploration, development, and production of crude oil and natural gas in the United States. The membership of IPAA includes natural gas producers in Kansas. IPAA participates in legislative, federal regulatory and litigation matters on behalf of its members.

The Kansas Independent Oil and Gas Association ("KIOGA"), an organization of over 850 members, represents independent oil and gas producers and operators, supporting petroleum industry professionals and service and supply companies who serve the industry throughout Kansas. KIOGA is vitally concerned with matters which impact the oil and gas industry, which is a fundamental component in the economy of Kansas.

The decision by the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") in the proceedings below will have a significant adverse impact on producers in Kansas. The practical economic impact of this decision will be felt by many IPAA and KIOGA members.

IPAA's and KIOGA's familiarity with the natural gas industry in the State of Kansas and with the adverse economic consequences that the decision of the D.C. Circuit will have on producers and production will benefit the Court in considering this case. IPAA and KIOGA therefore submit this brief of *amici curiae* in support of petitioners, Amoco Production Company, *et al.*

This brief is filed with the consent of the parties. Consent letters have been filed with the Clerk.

STATEMENT OF THE CASE

This case arises from a 1996 decision of the D.C. Circuit modifying a Federal Energy Regulatory Commission ("FERC" or "Commission") order imposing liability on gas producers for *ad valorem* taxes charged to customers. *Public Serv. Co. of Colo. v. FERC*, 91 F.3d 1478 (D.C. Cir. 1996). FERC initially ordered refunds retroactive to 1988. *Colo. Interstate Gas Co.*, 65 F.E.R.C. ¶ 61,292 (1993). The D.C. Circuit's decision increased the liability of producers by ordering refunds for natural gas production retroactive to October 1983. *Public Serv. Co. of Colo.*, 91 F.3d at 1490. While the Court affirmed the FERC holding that the Kansas *ad valorem* tax is not subject to recovery from purchasers under Section 110 of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 - 3432 (1978), the Court refused to defer to the carefully reasoned remedy adopted by the Commission.[1] The estimated impact of this decision on Kansas Gas Producers is almost one-half billion dollars.

The facts are set forth fully in the Petition and will not be repeated here, except to note that, the history of this case

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[1] The D.C. Circuit imposed liability for refunds beginning in October 1983 because that was "the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under Section 110 of the NGPA was at issue...". *Public Serv. Co. of Colo.*, 91 F.3d at 1490. This reasoning clearly ignores the prior regulatory treatment of the Kansas *ad valorem* tax, upon which producers had relied since 1974.

extends back to 1974 when the Federal Power Commission ("FPC"), predecessor to the FERC, initially promulgated national maximum rates under the Natural Gas Act ("NGA"), 15 U.S.C. § 717 (1978), for producer sales.

In 1974, the FPC provided that, under the NGA, the maximum applicable rate "shall be adjusted upward for all State or Federal production, severance, or similar taxes." Opinion No. 699, 51 F.P.C. 2212, 2301 (1974). In that same year, at the request of the Corporation Commission of the State of Kansas ("KCC"), the FPC issued a subsequent opinion, clarifying Opinion No. 699, and providing further guidance allowing producers making jurisdictional sales in Kansas to adjust upward the national rate prescribed in Opinion No. 699 by the amount of the Kansas *ad valorem* tax. The FPC held that the Kansas *ad valorem* tax was a severance tax because "the bulk of the Kansas *ad valorem* tax is based upon production factors, and, as such, is in fact, a severance or production tax merely bearing the title '*ad valorem* tax.'" Opinion No. 699-D, 52 F.P.C. 915 (1974).[2] The FPC decision was a final ruling by a federal agency.

SUMMARY OF ARGUMENT

Natural gas production in Kansas is important not only to producers but to the economy of the state. Natural gas and/or oil is produced in 89 of the 105 counties in Kansas.

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[2] The FPC issued a supplemental order to Opinion No. 699-D articulating the proper procedure for collecting the Kansas *ad valorem* tax. *See* Order Supplementing Opinion No. 699-D, 52 F.P.C. 1326 (1974). This supplemental order further evidences the FPC's intent to treat the Kansas tax as an "upward adjustment" and, accordingly, recoverable as part of the national rate established in Opinion No. 699. *See id.*

Independent Petroleum Association of America, *Petroleum Independent*, Sept.-Oct. 1996, at 44. Much of the gas production comes from stripper wells, which are particularly vulnerable to the economic effects of the D.C. Circuit's decision. In 1995, the average number of employees engaged in the oil and gas business in Kansas was 24,002. *Id.* at 45. That does not include the land owners who receive royalty payments from the sale of oil and gas. The entire industry, including land owners, will be fiscally disadvantaged if the substantial additional refunds ordered retroactively by the D.C. Circuit are allowed to stand.

Producers and operators have historically relied on FERC for guidance and have followed, since Opinion No. 699 was issued in 1974, the specific rulings of the FPC and FERC as well as the legislative history of the NGPA allowing for recovery of severance taxes. When the Commission made the determination that the Kansas *ad valorem* tax would no longer be treated as a severance tax under Section 110 of the NGPA, the Commission set a reasonable retroactive date of recovery for it. Entities subject to regulation by federal agencies, as in this case, must be entitled to rely upon the validity of final agency determinations. *See* Administrative Procedure Act ("APA") 5 U.S.C. § 557(b) (1996). Kansas producers did so. It is patently unfair to permit, as the D.C. Circuit did in the case at bar, final agency orders, which are challenged many years later, to undercut all prior regulation. The 1974 FPC determination to allow recovery of the Kansas *ad valorem* tax as a severance tax under Section 110 of the NGPA remained in effect until overturned by FERC on remand from the D.C. Circuit in 1988. A decision that notice and refunds attach whenever a pleading is filed with an administrative agency means no one can ever rely upon final agency orders.

Additionally, to suggest, as Williams Natural Gas does in its Cross-Petition for Writ of Certiorari, that refunds should be retroactive to 1978 is untenable. To order refunds retroactive to 1978 would be a punitive measure imposed upon producers who were acting in accordance with a final FERC determination on how the Kansas *ad valorem* tax should be treated.

FERC understood that its order would severely impact natural gas producers, and sought to appropriately balance the liability for the *ad valorem* taxes between the producers and their customers. By contrast, the additional $500 million burden that the D.C. Circuit has imposed on producers fails to balance the equities involved. The practical impact of this burden will affect the entire industry and, if not reversed, could lead to the abandonment of certain wells, particularly stripper wells, resulting in loss of a precious natural resource. The D.C. Circuit's decision further demonstrates that decisions such as this are properly made by the agency charged with responsibility for overseeing the statute and regulating the industry -- the agency which understands the consequences to the industry and the economy when imposing retroactive liability.

ARGUMENT

I. The D.C. Circuit Decision Will Have a Significant Adverse Impact on Natural Gas Producers and the State of Kansas.

Natural gas production in Kansas is unique. There were 14,878 natural gas wells producing in 1995 in the state but over 19% (2,830) of the wells were stripper wells as defined by the NGPA. *See* 15 U.S.C. § 3301 (1978). Stripper wells are a

special category recognized by Congress in the NGPA as economically marginal wells which required separate legislative consideration in order to avoid premature abandonment and the loss of otherwise recoverable natural gas reserves.[3] According to data collected by the KCC, the 2,830 stripper wells produced a total of 36.6 Bcf of gas in 1995. Independent Petroleum Association of America, *Petroleum Independent*, Sept.-Oct. 1996, at 44. While these wells constituted significant production in total, the wells only produced an average of 35.4 Mcf per day. *Id.* The average price of gas in Kansas at the wellhead was only $1.37 per Mcf; the average stripper well generated a meager $48.50 per day in gross revenue. *Id.* at 45. That amount is reduced by royalty payments (generally 12.5%), county and state taxes (14%), and operating expenses.

Stripper wells accounted for more than $10 billion in U.S. economic activity and more than 28,000 jobs nationwide in 1995. Interstate Oil and Gas Compact Commission, *Marginal Oil and Gas: Fuel for Economic Growth* (1996). These wells are a vital source of domestic production, accounting for approximately 14 percent of U.S. oil production and 4.7 percent of U.S. gas production. *Id.*[4] While stripper wells may be considered marginal, they are not disposable. The

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[3] *See* H.R. CONF REP. No. 1752, 95th CONG., 2d SESS. 88 (1978); STAFF OF HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE & STAFF OF SENATE COMM. ON ENERGY & NATURAL RESOURCES, 95th CONG., 2d SESS., NATURAL GAS PRICING AGREEMENT ADOPTED BY CONFERREES ON H.R. 5289 (Comm. Print 1978).

[4] Stripper oil and gas well production generated $1.37 billion in employment earnings and $3120 million in severance taxes for the country last year. *Id.*

United States is the only country with significant production from stripper wells. The decision of the D.C. Circuit however, will encourage the premature abandonment of stripper wells, because production from such wells will no longer be economically viable. Once stripper wells are plugged it is not economically feasible to reopen them and their resource is gone forever.

Conservation and prevention of waste are legitimate issues of concern for producers in Kansas. An additional five year retroactive refund neglects these issues and fails to account for the realistic impact of such neglect on those producers, and, ultimately, the orderly use of a limited natural resource. This added liability will impose sufficient hardship on producers such that the production of natural gas will be a fiscal impossibility, forcing many producers to either shut down wells and/or declare bankruptcy, leaving significant amounts of natural gas untapped. This waste is precisely what the State of Kansas, and, ultimately the Commission, were trying to avoid by allowing the Kansas *ad valorem* tax to be recovered as a severance tax. Appropriately, the FERC decision crafted a remedy reflecting the competing considerations and burdens; the impact of a remedy must be carefully considered as the Commission did in exercising its extensive knowledge of the industry, the economics of the industry and regulatory history. The D.C. Circuit failed to take into consideration the need for conservation and protection against waste, both which could be impacted from premature abandonment of stripper wells.

Natural gas producers operate in more than one state. To the extent the additional refund obligation imposed by the

D.C. Circuit causes extreme financial hardship to a producer, the producer's drilling and production activities in all states will be jeopardized.

This case raises substantial economic impact concerns. Those concerns, while most acute in Kansas, extend beyond state borders. The magnitude of the impact warrants review of the D.C. Circuit decision by this Court.

II. Final Agency Decisions Must Not be Rendered Meaningless by Later Court Determinations.

In 1974, the FPC ruled that the Kansas *ad valorem* tax could properly be recovered by natural gas producers from their purchasers *in addition to* the purchase price. It was an appropriate add-on. The FPC order was not challenged. Neither were subsequent FPC and FERC orders which affirmed that determination. The clear regulatory policy was to allow recovery of the Kansas *ad valorem* tax by producers from gas purchasers.

In 1978, Congress codified the FPC's prior regulatory treatment of state tax costs. Under Section 110 of the NGPA, the price charged for the first sale of natural gas could exceed the otherwise applicable maximum lawful price to the extent necessary to recover any "State severance taxes attributable to the production of ... natural gas borne by the seller." 15 U.S.C. § 3320(c) (1988). FERC incorporated the FPC's pre-NGPA regulatory scheme, including the pre-NGPA ruling on the Kansas *ad valorem* tax, into its post-NGPA analysis. Subsequently, FERC followed the pre-NGPA Kansas tax decision in authorizing producers to recover costs of other state taxes under Section 110 of the NGPA.

FERC affirmed its earlier treatment of the Kansas *ad valorem* tax in 1979. *Independent Oil & Gas Assoc. of W. Va.*, 7 F.E.R.C. ¶ 61,094 (1979). The Commission held a similar West Virginia property tax (*ad valorem* tax) was a "production, severance, or similar tax" within the meaning of Opinion Nos. 699-H, 52 F.P.C. 1604 (1974), and 770-A, 56 F.P.C. 2698 (1976).[5] In 1982, the Commission reiterated its position that taxes related to production shall be treated as severance taxes when it held that a West Virginia service tax may be collected by the producer and such collection will not be considered to exceed the applicable maximum lawful price. *Trio Petroleum Corp.*, 18 F.E.R.C. ¶ 61,203 (1982). In reaching this position, FERC noted its conclusion was supported by language in the Joint Explanatory Statement of the Committee of Conference of the NGPA. The term "State severance tax" is intended to be construed broadly. *Id.* (*citing* H.R. REP. No. 1752, 95th Cong., 2d Sess. 91 (1978)).

Nine years after the initial agency decision permitting recovery of the *ad valorem* tax from gas purchasers, Northern Natural Gas Company ("NNGC") petitioned FERC to reconsider the FPC's 1974 Kansas tax ruling. FERC denied NNGC's request for rehearing on several grounds and affirmed

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[5] Commission Opinion Nos. 699-H and 770-A established the rate of general applicability under the NGA. These opinions include a tax adjustment provision which is codified in Section 2.56a(b) of the Commission's General Policy and Interpretation. *Independent Oil & Gas Assoc. of W. Va.*, 7 F.E.R.C. ¶ 61,094 (1979). The Commission also cited Opinion 699-D, 52 F.P.C. 915 (1974), for the proposition that "the Kansas *ad valorem* tax was based upon production factors and was therefore a proper upward adjustment to the national rate, and ordered that any state *ad valorem* tax which is based upon production factors will in the future be considered a 'similar tax.' The ruling there also applies to Opinion No. 770-A." *Id.*

its consistent historical treatment of the Kansas tax. *See Sun Exploration & Prod. Co.*, 36 F.E.R.C. ¶ 61,093 (1986), *reh'g denied sub nom. Northern Natural Gas Co.*, 38 F.E.R.C. ¶ 61,062 (1987). Upon review of that decision, the D.C. Circuit remanded the matter to FERC for further clarification of its position that the Kansas tax qualified as a severance tax under Section 110 of the NGPA. *See Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769, 771 (D.C. Cir. 1988). Subsequently, in 1993, FERC reversed its prior decisions spanning the previous nineteen years, and held for the first time that the Kansas tax did not qualify as a severance tax under Section 110 of the NGPA.[6]

In reaching this conclusion the Commission was careful to review provisions for adopting a proper remedy. In exercising its discretion, the Commission employed the resources available to it as the agency charged with making national policy determinations of this nature. FERC, in balancing all competing interests including the federal court administrative retroactivity standards, concluded that refunds should be offered retroactive to 1988, the year the industry was first put on notice that taxes such as the Kansas *ad valorem* tax would no longer be treated as severance taxes under the NGPA Section 110.[7] Subsequently, on petition for review, the D.C.

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[6] Colorado Interstate Gas Co., 65 F.E.R.C. ¶ 61,292 (1993). Although this decision was challenged in the proceedings below, producers are not contesting the issue in this court. *See* Petition for Writ of Certiorari at 5 n.3. *Amici's* purpose in reviewing this issue is to contrast the years of reliance on FERC's treatment of the Kansas tax with the D.C. Circuit's arbitrary decision to order refunds retroactive to 1983.

[7] *Colorado Interstate Gas Co.*, 65 F.E.R.C. at 62,372 (stating "Upon review of the relevant court standards of administrative retroactivity we conclude that [the Commission's] ruling should be applied retroactively

Circuit arbitrarily imposed five more years of refund requirements beyond the refunds ordered by FERC, based on notice published in the Federal Register.[8] With interest, it is estimated that the total additional refund obligation approaches $500 million. The decision reflects an important lack of understanding on behalf of the D.C. Circuit as to the genuine impact of its decision, an impact that was understood and properly addressed by the Commission, and, more importantly, violates the APA 5 U.S.C. § 551-559 (1996) by failing to defer to agency discretion.

Congress recognized the need for regulatory certainty in the energy industry by permitting changes in rates resulting from complaint proceedings under Section 5 of the NGA, 15 U.S.C. § 717(d) (1996), *prospectively only from the date of a final Commission order or court order*. The interstate pipeline request to rescind recovery of the *ad valorem* tax was a complaint similar to an NGA Section 5 complaint. FERC denied the complaint in 1987. However, the D.C. Circuit ruled that the mere filing of the complaint triggered refund liability. The decision eliminates the fundamental concepts of fairness and regulatory certainty.

The very nature of regulation requires that parties subject to that regulation be allowed to rely on final decisions

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to the date of the court's decision in [*Colorado Interstate Gas*], June 28, 1988.")

[8] *See Public Service Co. of Colo.*, 91 F.3d at 1490. ("...we hold that the producers liability for refunds extends back to October 1983, the date when all interested parties were given notice in the Federal Register that the recoverability of the Kansas tax under § 100 of the NGPA was at issue...").

by the regulatory body which have not been appealed or which have been confirmed on appeal. The D.C. Circuit decision makes all such regulatory decisions meaningless if anyone later raises an issue in a regulatory proceeding, *even if the regulatory body affirms its prior decision*. The D.C. Circuit decision calls into question all final decisions by regulatory agencies. Reliance on agency decisions is fundamentally important to any industry subject to regulation. To allow the D.C. Circuit to arrogate this certainty through arbitrary decisions, such as this retroactive refund, undermines the purpose of federal regulation and, accordingly, warrants review.

CONCLUSION

For the reasons stated above, IPAA and KIOGA respectfully request the Court grant the Petition for Writ of Certiorari and review and reverse the decision below.

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PETITIONERS' REPLY BRIEF

No party disputes that a D.C. Circuit decision applying *de novo* review to an agency's exercise of remedial discretion would conflict with the decisions of other circuits and would raise an important, recurring issue of administrative law meriting this Court's review. Nor does anyone question the magnitude of the potential refund liability imposed retroactively by the court—nearly half a billion dollars—or its disruptive effect on producers and royalty owners who acted throughout the relevant period pursuant to agency orders expressly authorizing the conduct at issue.

In questioning the issue's certworthiness, Public Service Company of Colorado ("PSCC")[1] asserts, and the Solici-

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[1] PSCC's brief in opposition is joined by both Cheyenne Light, Fuel and Power and the Missouri Public Service Commission. For simplicity, we refer to these parties jointly as PSCC.

tor General intimates, that the decision rests on the peculiar terms of a repealed statute, under which Congress supposedly required automatic refunds in all cases and stripped the agency of its normal remedial discretion. But that view, as FERC argued persuasively in its court of appeals rehearing papers, both misreads the court's opinion and misconceives the NGPA.

1. There is *nothing* in the D.C. Circuit's opinion to suggest that the court's remedial analysis rested on some quirk in the NGPA that automatically and universally requires refunds. On the contrary, the court of appeals grounded its determination in its understanding of general principles of administrative law—in particular, its view that an agency lacks discretion to limit refunds in the absence of "detrimental reliance" (as narrowly defined by the court). Pet. App. 23a. As FERC correctly stated in its rehearing papers, the court's "detrimental reliance" analysis would have made "no sense had the panel believed the NGPA deprives the Commission of any authority to limit refunds."[2] In that case, refunds would have been mandatory without regard to whether there had been such reliance.

PSCC nonetheless professes to find in the opinion evidence that the court of appeals adopted this view of mandatory refunds. But it relies only on an artfully cropped fragment of language lifted from the court's *description of PSCC's argument*, and it implies—inaccurately—that the passage reflects the *court's own view* as well. This is evident if one compares the relevant portion of the court's opinion with PSCC's selective quotation (which omits the italicized words):

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[2] Reply of the Federal Energy Regulatory Commission to Responses to Petition for Rehearing and Suggestion for Rehearing *In Banc* at 2. This reply was lodged with the D.C. Circuit, but the court ultimately denied FERC's motion for leave to file it.

Court's Opinion (Pet. App. 22a)	PSCC Opposition (at 8)
In support of making the Commission's decision retroactive to 1983, PSCC offers a different account . . . of the transition from the NGA to the NGPA. In this version the key point is that the Commission does not have the expansive remedial powers under the NGPA that it wielded under the NGA, 15 U.S.C. § 717c(e). Specifically, whereas the NGA gave	This critical distinction in regulatory regimes was not lost upon the court below: [T]he key point [made by PSCC] is that the Commission does not have the expansive remedial powers under the NGPA that it wielded under the NGA, 15 U.S.C. § 717c(e). Specifically, whereas the NGA gave . . . .

The fact is that the court did *not* endorse PSCC's argument. Instead, having recounted the competing positions of all parties, the court went on to explain its *own*, quite different view of the case. "As we see the issue," the court stated, the "crucial point" is the supposed "lack of detrimental reliance." Pet. App. 23a. That view not only differs from, but also conflicts with, PSCC's theory.

2. Nor is there any support for the claim that the NGPA uniquely constrains agency authority to limit refunds. Neither PSCC nor the Solicitor General—who, hedging his bet, says only that there may be "some basis" for such a limitation (FERC Opp. 8)—can point to *any* statutory text that even arguably requires automatic refunds in all cases. No such text exists. On the contrary, as FERC correctly told the court of appeals, the NGPA (whose "necessary and proper clause," 15 U.S.C. § 3411(a), provides the exclusive source of the Commission's power to award refunds under that statute) confers remedial discretion that is, "if anything, *even broader* than under the [Natural Gas Act]." [3]

That the NGPA imposed ceiling prices for specific categories of natural gas does not alter the analysis. Contrary to PSCC's assertion, Congress did not confine FERC to the "limited task of determining when collected prices ex-

[3] FERC Petition for Rehearing and Suggestion for Rehearing *In Banc* at 14 n.5 (emphasis added).

ceed the statutory limits." PSCC Opp. 8. Rather, it delegated to FERC the traditional authority to interpret and apply provisions that fall short of perfect clarity. The statutory question before FERC in this case, for example, was whether a particular state tax qualified as a "severance, production, or similar tax, fee, or other levy imposed on the production of natural gas." 15 U.S.C. § 3320(c). The answer to that question, as the D.C. Circuit acknowledged, required the agency to construe inherently "ambiguous" terms. Pet. App. 6a.

The hidden premise of PSCC's argument is that, if FERC changes its interpretation of such terms (as it surely is entitled to do), it must automatically recalculate the statutory ceiling prices retroactively and require refunds as if the new interpretation had been in effect all along. PSCC's theory presupposes that there can be only one right answer to the statutory question, and that the agency must mechanically apply its most recent interpretation both prospectively and retrospectively without any regard for equitable considerations.

As this Court's decisions make clear, however, there may be more than one reasonable interpretation of ambiguous statutory terms. If an agency initially adopts one interpretation but later changes its mind and adopts a new interpretation, the courts must defer to *both* interpretations if both are reasonable. *See Rust v. Sullivan,* 500 U.S. 173, 186-87 (1991); *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 862-64 (1984). Just as "[a]n initial agency interpretation is not instantly carved in stone," and an agency need not "establish rules of conduct to last forever," *Rust,* 500 U.S. at 186 (internal quotations omitted), a *new* interpretation need not be given rigidly *retrospective* effect when, as here, the result would be to penalize those who properly conformed their behavior to the original interpretation. To conclude otherwise would conflict with the theory of *Chevron* deference and would undermine an agency's "latitude to adapt [its]

rules and policies to the demands of changing circumstances." *Id.* at 187 (internal quotations omitted).

3. Although respondents question whether the D.C. Circuit actually engaged in *de novo* review (PSSC Opp. 5-6; FERC Opp. 7-8), any other conclusion is wholly implausible. The court plainly conducted an independent remedial analysis, concluding on its own that "detrimental reliance" was the lone "crucial point" and that there was no such reliance in this case. Pet. App. 23a. Similarly, without even mentioning—much less deferring to—FERC's contrary understanding of the NGPA, the court independently decided that enactment of the NGPA made any later reliance "unreasonable." Pet. App. 24a.

PSCC imputes significance to the court's statement that, "[a]bsent detrimental and reasonable reliance," it would be "capricious" for the agency to forgo refunds "without any justification at all." *Id.* But that demonstrates only that the court was prepared to label "capricious" any result that differed from its own conclusion, reached after an independent analysis of "detrimental" and "reasonable" reliance. This is not the way a court behaves when it is reviewing under a rational-basis or abuse-of-discretion standard an agency's exercise of discretionary authority.

PSCC asserts that the result in this case would have been no different under the deferential standard of review applied by other circuits. PSCC Opp. 5. It rests that assertion on the D.C. Circuit's statement that any reliance on the agency's orders after enactment of the NGPA "would have been foolhardy." Pet. App. 24a. But FERC itself reached precisely the opposite conclusion, specifically finding that reliance on its orders was entirely "justifiable" until 1988. Pet. App. 78a. That was so, FERC explained, because (1) the NGPA's terms and underlying legislative history gave every reason to believe that "the prior characterization of the Kansas tax would carry over under the NGPA," and (2) FERC itself, in orders entered *under* the NGPA, expressly and repeatedly relied on its pre-NGPA

Kansas tax ruling to hold that other state taxes qualified as "production or severance" taxes. *Id.*

The D.C. Circuit nowhere addressed FERC's analysis. Its conclusion that continued reliance was unjustified reflects, not a deferential review of the agency's plainly reasonable contrary findings about the statute it administers and its own prior decisions, but a *de novo* determination by the court itself. It is inconceivable that the outcome would have been the same had the court applied the deferential standard of review that prevails in other circuits.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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